esma European Securities and Markets Authority

# Consultation paper

ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive in relation to supervision and third countries

August 2011 | ESMA/2011/270

European Securities and Markets Authority

Date: 23 August 2011
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## Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- indicate the specific question to which the comment relates;
- respond to the question stated;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

Comments should reach us by **23 September 2011**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Consultations'. Respondents should identify themselves and indicate the industry sector in which they operate or in which they are interested and the extent to which that sector is already subject to regulation at a national level. Respondents are also invited to consider the costs or benefits attached to the various options and quantify these costs to the extent possible.

### Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

### Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Disclaimer'.

### Who should read this paper

This paper will be of interest to managers, depositaries and prime brokers of alternative investment funds, investors in those funds, as well as associations or other bodies representing such entities.

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## Acronyms used

| | |
|---|---|
| AIF | Alternative Investment Fund |
| AIFM | Alternative Investment Fund Manager |
| CESR | Committee of European Securities Regulators |
| ESMA | European Securities and Markets Authority |
| EU | European Union |
| IOSCO | International Organization of Securities Commissions |
| MMoU | Multilateral Memorandum of Understanding |
| MoU | Memorandum of Understanding |

## I. Executive Summary

### Reasons for publication

On 2 December 2010 the European Commission sent a request for assistance to CESR (now ESMA) on the content of the implementing measures for the Alternative Investment Fund Managers Directive (AIFMD).[1]

On 13 July 2011, ESMA published a consultation paper seeking feedback from external stakeholders on the draft advice to the European Commission on possible implementing measures for the AIFMD (ESMA/2011/209).[2] This consultation paper covered the first three parts of the Commission's request which dealt with general provisions, authorisation and operating conditions, depositary and transparency requirements and leverage.

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This consultation paper sets out ESMA's draft advice for possible implementing measures[3] regarding the fourth part of the Commission's request on supervision, as well as the measures on delegation to entities established in a third country and on general criteria for assessing equivalence of the effective prudential regulation and supervision of third countries in the context of depositaries.

### Next steps

In light of the feedback received from stakeholders, ESMA will finalise its proposals with a view to submitting its advice to the European Commission by the deadline of 16 November 2011.

[1] http://ec.europa.eu/internal_market/investment/docs/alternative_investments/level2/mandate_en.pdf
[2] http://www.esma.europa.eu/popup2.php?id=7625
[3] This paper uses the term 'implementing measures' as a generic term to refer to delegated acts and implementing acts.

## II. Background and introduction

1. The European Commission's proposal for a Directive on Alternative Investment Fund Managers was published in April 2009.[4] Following intensive negotiations among the co-legislators over the period that followed, a political compromise was reached on the draft Directive in October 2010. The following December, the Commission sent a request to CESR (now ESMA) for technical advice on the detailed implementing measures that should form part of the AIFMD framework. The Commission's request is split into four parts:

   - Part I: General provisions, authorisation and operating conditions
   - Part II: Depositary
   - Part III: Transparency requirements and leverage
   - Part IV: Supervision

2. Immediately upon receipt of the request for assistance, CESR published a call for evidence (Ref. CESR/10-1459)[5] inviting stakeholders to provide input on the main elements of the request. A total of 56 responses were received by the deadline of 14 January (the non-confidential responses are available on the ESMA website[6]).

3. This consultation paper sets out ESMA's draft advice for all the topics dealing with third countries in the AIFMD including those relating to supervisory co-operation, the marketing of non-EU AIFs, the delegation of certain functions (i.e. risk management and portfolio management) to service providers outside the EU and the appointment of non-EU depositaries.

4. Certain of the implementing measures foreseen under Part IV of the request are less urgent as they relate to the introduction of a passport for third country entities, which will not be operational until at least two years following the transposition deadline for the AIFMD. However, the co-operation arrangements referred to in the implementing measures under Articles 34(1), 36(1) and 42(1)(b) have to be in place as from the first day the national laws transposing the AIFMD take effect in 2013. ESMA has been working on developing draft proposals for these implementing measures, which are included in this consultation paper, with a view to submitting the advice to the Commission by 16 November.

5. The final text of the AIFMD, which will take effect in July 2013, was published in the Official Journal on 1 July.[7] All references to articles in this consultation paper relate to that version.

[4] http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_proposal_en.pdf
[5] http://www.esma.europa.eu/popup2.php?id=7318
[6] http://www.esma.europa.eu/index.php?page=responses&id=176
[7] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF

## III. Delegation (Articles 20 (1)(c), 20(1)(d) and 20(4)

**Extract from the Commission's request**

*CESR is invited to advise the Commission on the following, which are applicable, both to cases of delegation and sub-delegation:*
*(…)*
*In the event of a delegation of portfolio or risk management to an undertaking in a third country, how co-operation between the home Member State of the AIFM and the supervisory authority of the undertaking should be ensured.*

1. Several respondents to the call for evidence supported the use of MoUs based on international standards, such as the IOSCO MMoU. Some also expressed a preference for the development of an MMoU in order to avoid different bilateral arrangements.

**Box 1**

1. In order to fulfil the requirement set out in Article 20(1)(d) of the AIFMD a written arrangement should exist between the competent authorities of the home Member State of the AIFM or ESMA and the supervisory authorities of the undertaking to which delegation is conferred.

2. Where the undertaking sub-delegates any of the functions delegated to it, a written arrangement should exist between the competent authorities of the home Member State of the AIFM or ESMA and the relevant supervisory authorities of the undertaking to which sub-delegation is conferred.

3. Where the sub-delegate further delegates any of the functions delegated to it the conditions in paragraph 2 shall apply mutatis mutandis.

4. With respect to the delegated functions from the entity to which functions were delegated or sub-delegated, the arrangement referred to in paragraphs 1 and 2 above should entitle the competent authorities to:

a) obtain on request the relevant information necessary to carry out their supervisory tasks as provided for in AIFMD;

b) obtain access to the documents relevant for the performance of their supervisory duties maintained in the third country;

c) have the right to request an on-site inspection on the entity to which functions were delegated or sub-delegated. The practical procedures for on-site inspections should also be detailed in the arrangement;

d) receive immediately information from the supervisory authority in the third country in the case of breach of regulations;

e) ensure that enforcement actions can be performed in cases of breach of regulations.

5. The third country undertaking should be deemed to satisfy the requirement under Article 20(1)(c) when it is authorised or registered for the purpose of asset management based on local criteria which are equivalent to those established under EU legislation and is effectively supervised by an independent competent authority.

**Explanatory text**

2. Article 20 sets the conditions for delegation, sub-delegation and further sub-delegation of core functions such as portfolio management or risk management. In cases of delegation of portfolio management and risk management to entities established in third countries, the existence of appropriate co-operation with the third country supervisory authority is of paramount importance.

3. Article 20(1)(d) provides that 'where the delegation concerns portfolio management or risk management and is conferred on a third-country undertaking, in addition to the requirements in point (c), co-operation between the competent authorities of the home Member State of the AIFM and the supervisory authority of the undertaking must be ensured'.

4. In relation to sub-delegation Article 20(4) provides that 'the third party may sub-delegate any of the functions delegated to it provided that the following conditions are met: (...) (c) the conditions set out in paragraph 1, on the understanding that all references to the 'delegate' are read as references to the 'sub-delegate'. Paragraph 6 of the same Article clarifies that 'where the sub-delegate further delegates any of the functions delegated to it, the conditions set out in paragraph 4 shall apply mutatis mutandis'.

5. The joint reading of the above-mentioned provisions implies that the requirements dealing with co-operation arrangements with third countries apply not only with respect to the delegation of portfolio management and risk management by the AIFM but also in cases where the third party sub-delegates these functions.

6. Given the relevance of the delegated core functions both in terms of investor protection and containment of systemic risk, it is envisaged that the co-operation should be based on written arrangements. The right of the competent authority of the home Member State of the AIFM to obtain information on request or to have access to information and to the delegated entities should be well-grounded and based on arrangements in place before the delegation starts.

7. The detailed content of these arrangements should be based on existing international standards and, in particular, the IOSCO MMoU concerning consultation and co-operation and the exchange of information of May 2002 with respect to co-operation for enforcement purposes and, for supervisory purposes, the IOSCO Technical Committee Principles for Supervisory Co-operation (including the sample MoU concerning consultation, co-operation and the exchange of information related to the supervision of cross-border regulated entities).

8. These arrangements could take the form of an MMoU centrally negotiated by ESMA which would obviate the need that third country regulators conclude different bilateral co-operation arrangements and would ensure a level playing field.

9. A third country authority should be deemed to be independent if it fulfils the criteria set out in Part II ('The Regulator') of the IOSCO Objectives and Principles for Securities Regulation and relevant Methodology, and the Basel Committee Core Principles and the relevant Methodology[8]. These criteria will be used as a reference and a third country authority may meet other equivalent criteria. This does not imply that the assessed authority needs to be member of IOSCO or of the Basel Committee. The third country competent authorities should have the powers to obtain information and to enforce the relevant requirements under their domestic legislation.

10. As far as the equivalence assessment of the legislation is concerned, this should be made by comparing the eligibility criteria and the on-going operating conditions locally applicable to the third country undertakings against the corresponding requirements applicable in the EU for the access to the business and the performance of the relevant functions. Please refer to Box 67 of ESMA's draft advice on the implementing measures under Parts I to III of the Commission's request[9].

11. The provision in paragraph 4)c) of Box 1 according to which the competent authorities have the right to request an on-site inspection on the entity should be understood as covering two situations: i) where the competent authority of the home Member State of the AIFM requests the supervisory authority of the undertaking to which functions are delegated to carry out an inspection on its behalf; and ii) where the competent authority of the home Member State of the AIFM requests permission from the supervisory authority of the undertaking to which functions are delegated to carry out an inspection itself.

12. The advice in paragraph 5 of Box 1 relates to the requirement in the first four lines of Article 20(1)(c) i.e. that delegation of portfolio management or risk management can only be to an undertaking authorised or registered for the purpose of asset management. As set out in the remainder of that article, where this condition cannot be met there must be prior approval by the competent authorities of the home Member State of the AIFM.

**Q1: Do you agree with the above proposal? If not, please give reasons.**

**Q2: In particular, do you support the suggestion to use as a basis for the co-operation arrangements to be signed at EU level the IOSCO Multilateral Memorandum of Understanding of May 2002 and the IOSCO Technical Committee Principles for Supervisory Co-operation?**

[8] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf
[9] http://www.esma.europa.eu/index.php?page=document_details&id=7625&from_id=28

# IV. Depositary (Article 21(6))

**Extract from the Commission's request**

*CESR is requested to advise the Commission on the criteria for assessing whether the prudential regulation and supervision applicable to a depositary established in a third country with respect to its depositary duties are to the same effect as the provisions laid down in European law. In this regard, CESR is invited to take into account at least whether the depositary:*

*a) is subject to specific capital requirements for the safe-keeping of assets.*
*b) is subject to supervision on an on-going basis.*
*c) provides sufficient financial and professional guarantees to be able to effectively pursue its business as a depositary and meet the commitments inherent to that function.*
*d) is subject to rules as stringent as those laid down in Article 21 AIFMD.*

*CESR is requested to advise the Commission specifying the criteria for assessing that prudential regulation and supervision of a third country applicable to the AIF depositary with respect to its depositary duties established in a third country is to be considered as effectively enforced. Inter alia, CESR should take into account whether the depositary is subject to the oversight of a public authority, meaning that, at least:*

*a) the authority has the power to request information from the depositary.*

*b) the authority has the power to intervene with respect to, and sanction, the depositary.*

1. Some respondents to the call for evidence encouraged ESMA to develop a list of equivalent third countries. One respondent did not consider that any assessment of whether entities in the relevant third country were 'subject to rules as stringent as those laid down in Article 21 of the Directive' was a valid interpretation of the Level 1 requirement for Level 2 measures to determine whether a particular third country regime was 'to the same effect' as the prudential regulation and supervision rules that apply to those entities that may act as the depositary of an EU AIF. According to this respondent, the text of the Directive does not require there to be any express equivalent to Article 21 and suggested that the relevant criteria should fall into two key categories which were qualitative and quantitative criteria. More details about these criteria are provided in the feedback in Annex IV.

**Box 2**

1. For the purposes of the assessment provided for in Article 21 (6) the following criteria should be met:

    a. The entity should be subject to authorisation and on-going supervision by an independent competent authority with adequate resources to fulfil its tasks;

    b. The local regulatory framework should set out criteria for the eligibility to act as depositary that are equivalent to those set out for the access to the business of credit institution

or investment firm;

c. The capital requirements imposed in the third country should be equivalent to those applicable in the EU as set out in Article 21 (6) (b) depending on whether the entity is equivalent to a credit institution or to an investment firm;

d. The operating conditions are equivalent to those set out for credit institutions or investment firms within the EU depending on the nature of the entity;

e. The requirement on the performance of the specific duties as AIF depositary established in the third country regulatory framework are equivalent to those provided for in Article 21 ( 8) to (15) and in the relevant implementing provisions;

f. The local regulatory framework provides for the application of sufficiently dissuasive sanctions in cases of violations by the depositary;

g. The liability to the investors of the AIF can be invoked directly or indirectly through the AIFM, depending on the legal nature of the relationship between the depositary, the AIFM and the investors.

**Explanatory text**

2. The depositary established in a third country should be subject to regulation of a public nature and to prudential supervision performed by an independent competent authority.

3. Article 21(6)of the Directive sets out the preconditions concerning the possibility to appoint as a depositary an entity established in a third country requiring, inter alia, appropriate co-operation arrangements to be signed between competent authorities (including those of the countries where the units are to be marketed). Moreover, subparagraph b) expressly requires that the relevant entity is subject 'to effective prudential regulation, including minimum capital requirements, and supervision which have the same effect as Union law and are effectively enforced'.

4. This objective can only be achieved if the local regulation established in the third country guarantees that regulations of a public nature exist, the local competent authority performs on-going supervision and can perform investigations and impose sanctions.

5. A third country authority should be deemed to be independent if it fulfils the criteria set out in Part II ('The Regulator') of the IOSCO Objectives and Principles for Securities Regulation and relevant Methodology, and the Basel Committee Core Principles and the relevant methodology[10]. The criteria will be used as a reference. This does not imply that the assessed authority needs to be member of IOSCO or of the Basel Committee. The third country competent authority should have the powers to obtain information and to enforce the relevant requirements under the domestic legislation in the third country.

6. As far as the equivalence assessment of the legislation is concerned, this should be made by comparing the eligibility criteria and the on-going operating conditions applicable to the depositary in

[10] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf

the third country against the corresponding requirements provided for within the EU for credit institutions and/or investment firms for the access to the business and the performance of the depositary functions.

7. The European Commission, having verified that the above-mentioned criteria are met, may issue decisions declaring a given third country jurisdiction as equivalent.

**Q3: Do you agree with the above proposal? If not, please give reasons.**

**Q4: Do you have an alternative proposal on the equivalence criteria to be used instead of those suggested in point b above?**

# V. Supervision

## V.I. Co-operation between EU and third country competent authorities for the purposes of Article 34(1), 36(1) and 42(1) of the AIFMD

**Extract from the Commission's request**

*CESR is requested to advise the Commission on a common framework to facilitate the establishment of the co-operation arrangements with supervisory authorities from third countries in the different situations described above. CESR is requested to advise on the objectives, the parties and the scope of the co-operation arrangements. In relation to the arrangements for the purpose of systemic risk oversight referred to in Articles 36(1) and 40(1), they should cover, at least, the minimum information related to the potential systemic consequences of non-EU AIFM activity that competent authorities should exchange with their non-European counterparts, the procedure for the exchange of that information and the frequency of the exchange. CESR is encouraged to consider as a framework the reporting obligations laid down in Article 24 AIFMD.*

*CESR should take into account that, due to the non-binding nature of the administrative arrangements, they should have a limited scope (i.e. cannot create legal obligations), since they cannot be considered as international treaties.*

*CESR is encouraged to take into account the relevant international standards in this regard, in particular, the principles and standards related to the control of the potential systemic risk posed by AIFM of the International Organisation of Securities Commissions (IOSCO)'.*

1. Several respondents to the call for evidence supported the use of IOSCO and other international standards and also strongly recommended the publication of a central public database of details of the co-operation arrangements to allow easy identification by AIFMs of the relevant jurisdiction.

**Box 3**

1. The co-operation arrangement with the third country competent authority should be in writing and provide for:
    a. exchange of information for supervisory purposes;
    b. exchange of information for enforcement purposes;
    c. the right to obtain all information necessary for the performance of the duties provided for in the Directive;
    d. the right to request an on-site inspection to be performed or to perform directly such an on-site inspection.

2. The third country competent authority should assist the EU competent authorities where it is necessary to enforce EU legislation and national implementing legislation breached by the entity established in the third country.

3. Where specific reference is made to exchange of information for the purpose of systemic risk oversight, the arrangement should allow the EU competent authority to receive information on an on-going basis as provided for in Box 109 of ESMA draft advice to the European Commission on possible implementing measures of the AIFMD in order to discharge its duties under the Directive.

**Explanatory text**

2. The Directive grants rights with respect to entities established in third countries. In particular the following situations are provided for:

   - EU AIFMs managing non-EU AIFs which are not marketed in Member States;
   - EU AIFMs marketing non-EU AIFs in Member States without a passport; and
   - Non-EU AIFMs marketing EU or non-EU AIFs in Member States without a passport.

3. In order to ensure that these rights can be exercised in a way which is not detrimental to the protection of EU investors and to the stability of the European markets, the arrangements should ensure an on-going flow of information for supervisory purposes. It should also be ensured that enforcement can be performed if necessary. In this context, it is crucial to avoid creating an unlevel playing field which unduly favours entities established in third countries.

4. The agreement should be signed by the European competent authority(ies) and the local third country competent authority and could take the form of a MMoU centrally negotiated by ESMA. It should allow the European competent authority(ies) to exercise the powers conferred on to them by the Directive, taking into account the list of powers that they are entitled to exercise pursuant to Article 46 of the Directive.

5. The detailed content of the co-operation arrangements would be established by ESMA taking into account international standards and, in particular, the IOSCO Multilateral Memorandum of Understanding with respect to co-operation for enforcement purposes and, for supervisory purposes, the IOSCO Technical Committee Principles for Supervisory Co-operation (including the sample MoU).

6. An ad hoc clause should be included in the arrangements in order to allow the transfer of information received from a third country authority to other EU competent authorities, to ESMA or to the ESRB as envisaged by the Directive.

7. The competent authority in the third country should be able to meet the standards of data protection requested by the Data Protection Directive[11] as already provided for by Article 52 of the Directive. This includes additional confirmation of the ability of the relevant local authority to meet adequate standards concerning the treatment of information that can be classified as personal infor-

[11] Directive 95/46/EC

mation. The transfer of data may only be permitted under the conditions set out in Article 52 of the Directive.

8. As far as information which is necessary for the supervision for systemic risk purposes is concerned, it is important to ensure that the same information which is available for EU entities (EU AIFMs and AIFs) is available where relevant entities are established outside the EU. It may be worth mentioning that the information relevant for the systemic risk oversight in fact may have relevance both for the supervision of the AIFMs which are established within the EU and for the AIFs which are marketed within the EU territory. The draft content of the arrangement will be adapted to the specific situation taking into account the information which is deemed to be necessary for EU supervisory purposes.

9. It should be understood that in certain circumstances the information necessary for systemic risk oversight may need to be passed on to other EU competent authorities, to ESMA or to the ESRB.

10. The Directive refers to guidelines to be adopted by ESMA. ESMA will commit to adopt such guidelines by the time the Commission will complete the process for the issuance of Level 2 measures.

11. Where marketing of the units is envisaged in a country other than that of the EU competent authority which is the reference authority, the agreement could be signed as a joint agreement between all the authorities involved.

12. The written agreements necessary for the purposes of co-operation under the Directive may be based on a template established by ESMA at EU level.

**Q5: Do you agree with the above proposal? If not, please give reasons.**

**Q6: In particular, do you support the suggestion to use as a basis for the co-operation arrangement to be signed at EU level the IOSCO Multilateral Memorandum of Understanding of May 2002 and the IOSCO Technical Committee Principles for Supervisory Co-operation?**

## V.II. Co-operation arrangements between EU and non-EU competent authorities as required by Articles 35(2), 37(7)(d) and 39(2)(a) of AIFMD

**Extract from the Commission's request**

*CESR is requested to advise the Commission on a common framework to facilitate the establishment of co-operation arrangements with supervisory authorities from third countries in the different situations described above. CESR is requested to advise on the objectives, the parties and the scope of the co-operation arrangements. These arrangements should cover:*

*a) the modalities and conditions for the supervision of non-EU AIFM and funds and*
*b) the procedures for the exchange of information between the authorities involved.*

*The aim of these co-operation arrangements should be to ensure the efficient co-operation between supervisors and the effective supervision of the third country AIFM and/or AIF.*

*CESR should take into account that due to the non-binding nature of the administrative arrangements they should have a limited scope (i.e. cannot create legal obligations), since they cannot be considered as international treaties.*

*CESR is encouraged to take into account the international standards in this regard, in particular, the principles regarding cross-border supervisory co-operation of the International Organisation of Securities Commissions (IOSCO).*

1. Several respondents to the call for evidence supported also the use of IOSCO and other international standards and also strongly recommended the publication of a central pubic database of details of the co-operation agreements to allow easy identification by AIFM of relevant jurisdiction.

**Box 4**

1. The relevant provisions set out in Box 3 above could apply.
2. The final decision on the necessary safeguards in the case of a third country passport will be reassessed at the moment of the evaluation by ESMA required by Article 67 (i.e. before the entry into force of the relevant provisions in 2015)

**Explanatory text**

2. The request for advice covers the following situations:

- EU AIFMs marketing non-EU AIFs with a passport in the EU;
- Non-EU AIFMs authorised to manage EU AIFs and/or market AIFs in the EU with a passport; and

- Non-EU AIFMs marketing in the EU non-EU AIFs with a passport

3. The provisions related to the part of the Directive providing for the third country passport will be finalised at a later stage since such provisions are not intended to enter into force at the same time as the rest of the Directive (as they are subject to a future assessment). At the time the assessment is performed, ESMA will be able to advise whether or not additional or specific conditions are necessary.

4. Due account should be taken of Article 50(4) of the Directive, which foresees the transmission of relevant arrangements concluded by the home country regulator to the host country regulator as well as the right of the host competent authority to refer the matter to ESMA in case it believes that the arrangement is not in line with the relevant regulatory standards.

5. The Directive does not allow for the operation of a mutual recognition system with third countries, particularly with respect to the authorisation of non-EU AIFMs. This implies that an authorisation must be granted under the implementing legislation of the relevant EU Member State and that the relevant authority will assume primary responsibility insofar as the supervision of the entity established in the third country is concerned.

6. It may be worth mentioning in this respect that Article 37(7) expressly makes reference to appropriate co-operation arrangements being in place between the competent authorities of the Member State of reference, the competent authorities of the home Member State of the EU AIFs and the supervisory authorities of the third country where the non-EU AIFM is established, in order to ensure at least an efficient exchange of information that allows the competent authorities to carry out their duties in accordance with the Directive. These arrangements could take the form of a MMoU centrally negotiated by ESMA.

7. It is the Directive itself which does not allow for a more lenient approach in case of entities established in third countries. Therefore, the detailed content of the agreement should duly take this into account.

**Q7: Do you agree with the above proposal? If not, please give reasons.**

## V.III. Co-operation and exchange of information between EU competent authorities

**Extract from the Commission's request**

*CESR is requested to advise the Commission on the content of the level 2 measures on the exchange of information on the potential systemic consequences of AIFM activity. In particular CESR is requested to advise on what type of information could be exchanged among supervisors in order to facilitate supervisory co-operation in identifying potential systemic risks and risks to the orderly functioning of markets posed by AIFM individually or collectively, taking into account the reporting requirements on AIFM pursuant to Article 24.*

*CESR is requested to advise the Commission on a template, a data format, and the conditions of secured data transmission for the exchange of data among competent authorities. CESR is also requested to advise on the periodicity of the exchange of the information.*

8. In the request for assistance from the European Commission it is specified that consideration should be given to the list of information to be requested pursuant to the implementing measures under Article 24 (Reporting obligations to competent authorities). ESMA has developed a template with the list of relevant information to be communicated by AIFMs to competent authorities in the consultation paper published on 13 July 2011 on draft implementing measures on AIFMD. ESMA will finalise the list of information to be exchanged taking into account the final advice under Article 24.

9. As for the means to exchange secure information, ESMA is developing a system to comply with the requirements established in other pieces of EU legislation; this part of the advice will therefore be dealt with jointly with the development of the above-mentioned project. In this respect there is no need to work on the basis of consulting on these issues.

**Q8: Do you agree with the above proposal? If not, please give reasons.**

## V.IV. Member State of reference: authorisation of non-EU AIFMs – Opt-in (Article 37(4))

**Extract from the Commission's request**

*CESR is requested to advise the Commission on the procedure to be followed by Member States when determining the Member State of reference in cases where there are several possible Member States of reference. This advice should discuss a number of alternatives. It should take the following aspects into account: legal certainty, risk of regulatory arbitrage and potential impact/costs on the AIFM, the investors in the AIF it manages, and the competent authorities involved'.*

**Box 5**

1. In cases of conflict between competent authorities of several Member States, the Member State of reference should be identified taking into account the Member State in which the AIFM intends to develop most effective marketing for its AIFs pursuant Article 37(4) (h).

2. The competent authorities identified by non-EU AIFM as the potential authorities of reference should immediately upon reception of the request, and no more than 48 hours following the reception of the request, contact each other and ESMA in order to consult on whether any other EU competent authorities or ESMA could potentially be involved pursuant to Article 37(4).

3. Where other EU competent authorities could potentially be involved, ESMA should immediately inform them.

4. The information referred to in paragraph 2 above should include the submission made by the non-EU AIFM, including in particular the details referred to in the last subparagraph of Article 37(4).

5. Within one week of their initial consultation or, where applicable, of receipt of the information by the other EU competent authorities, all the relevant competent authorities should exchange their views and jointly take a decision on the identification of the Member State of reference.

6. ESMA should facilitate the agreement between the relevant competent authorities.

**Explanatory text**

1. The criteria to be followed seem to be listed in the Directive. At present it appears difficult to identify additional criteria. However, a more detailed procedure could be established in addition to what is provided in the Directive.

2. The Member State where the AIFM develops most effective marketing for its AIFs should mean the Member State where the AIFM intends to target investors by promoting and offering, including through third party distributors, most of the AIFs.

3. The procedure to be followed when a non-EU AIFM opts in to benefit from the EU marketing passport should be the same as for EU AIFMs.

**Q9:Do you have any suggestions on possible further criteria to identify the Member State of reference?**

**Q10:Do you think that any implementing measures are necessary in the context of Member State of reference given the relatively comprehensive framework in the AIFMD itself?**

**Q11:Do you agree with the proposed time period for competent authorities identified as potential authorities of reference to contact each other and ESMA?**

**Annex I: Summary of questions**

**Delegation**

**Q1:Do you agree with the above proposal? If not, please give reasons.**

**Q2:In particular, do you support the suggestion to use as a basis for the co-operation arrangements to be signed at EU level the IOSCO Multilateral Memorandum of Understanding of May 2002 and the IOSCO Technical Committee Principles for Supervisory Co-operation?**

**Depositaries**

**Q3:Do you agree with the above proposal? If not, please give reasons**

**Q4:Do you have an alternative proposal on the equivalence criteria to be used instead of those suggested in point b above?**

**Co-operation between EU and third country competent authorities for the purposes of Article 34 (1), 36 (1) and 42 (1) of AIFMD**

**Q5:Do you agree with the above proposal? If not, please give reasons.**

**Q6:In particular, do you support the suggestion to use as a basis for the co-operation arrangement to be signed at EU level the IOSCO Multilateral Memorandum of Understanding of May 2002 and the IOSCO Technical Committee Principles for Supervisory Co-operation?**

**Co-operation arrangements between EU and non-EU competent authorities a required by Articles 35(2), 37(7)(d) and 39(2)(a) of AIFMD**

**Q7:Do you agree with the above proposal? If not, please give reasons.**

**Co-operation and Exchange of Information between EU competent authorities**

**Q8:Do you agree with the above proposal? If not, please give reasons.**

**State of reference: authorisation of non-EU AIFMs – Opt-in (Article 37(4))**

**Q9:Do you have any suggestions on possible further criteria to identify the Member State of reference?**

**Q10:Do you think that any implementing measures are necessary in the context of Member State of reference given the relatively comprehensive framework in the AIFMD itself?**

**Q11:Do you agree with the proposed time period for competent authorities identified as potential authorities of reference to contact each other and ESMA?**

**Annex II: Commission's request for assistance to ESMA**

http://ec.europa.eu/internal_market/investment/docs/alternative_investments/level2/mandate_en.pdf

**Annex III: Cost-benefit analysis**

| Options | Benefits | Costs | Evidence |
|---|---|---|---|
| **1. Delegation** | | | |
| **Option 1:** Option displayed in the consultation paper in Box 1 in paragraph 4 | Provide a high level of comfort to the competent authority of the AIFM in terms of supervision of the delegate or sub-delegate.<br><br>The competent authority of the AIFM can perform on-site inspections on the entity to which functions are delegated or sub-delegated.<br><br>It ensures that enforcement actions can be performed in case of breach of regulation by the entity to which functions are delegated or sub-delegated. | Delegation in some third countries may not be possible if the conditions specified in ESMA's draft advice are not complied with. | Feedback from the consultation |
| **Option 2**: No specific requirements in terms of co-operation between competent authorities. | Flexibility concerning the prudential regulation and supervision applicable to entities established in third countries to which functions are delegated. | Competent authorities of AIFMs may not be provided with a high level of comfort in terms of supervision of the delegate or sub-delegate.<br><br>Investor protection may be undermined. | Feedback from the consultation |
| **2. Depositaries** | | | |
| **Option 1:** Option displayed in the consultation paper under Box 2. | Provide a high level of comfort in terms of investor protection and a level playing field in terms of requirements that should be met by depositaries or sub-custodians established in a third country. | Appointment of a depositary or a sub-custodian in third countries which do not comply with the provisions specified in ESMA's draft advice would not be possible. | Feedback from the consultation |
| **Option 2:** No specific requirements on the | No limitation and constraint concerning the | No comfort on the quality and the level of | Feedback from the consultation |

| | | | |
|---|---|---|---|
| assessment of the prudential regulation and supervision applicable to a depositary established in a third country | prudential regulation and supervision applicable to a depositary established in a third country. | the prudential regulation and supervision applicable to a depositary established in a third country.<br><br>Investor protection may be undermined. | |

## Annex IV: Feedback on the call for evidence

### Delegation

1. In the context of co-operation between competent authorities when the delegate is in a third country, several respondents supported the use of MoUs based on international standards, such as the IOSCO MoU. Some respondents also recommended the use of a single co-operation agreement encompassing all third country issues.

### Depositaries

2. ESMA received a significant number of contributions during the call for evidence concerning the issue of delegation of portfolio management and risk management. The main contributions are summarised below.

3. One respondent was of the view that institutions subject to the Capital Requirements Directive 2006/48/EC (which includes credit institutions and investment firms) were the most suitable entities to fulfil AIF depositary requirements.

4. One stakeholder believed that the relevant public authority should have the power to request information and to intervene or impose sanctions on the depositary. The same stakeholder believed that, as a prerequisite, public authorities should be granted the effective authority to explicitly authorise the depositary to perform its functions for non-EU AIFs that might be distributed in the European Union.

5. One contributor stressed that depositaries were mostly authorised as credit institutions and noted that in cases where the banking and securities supervisors were separate, the securities supervisors may not be able to conclude the same sort of Memorandum of Understanding with the banking supervisor as securities supervisors have among themselves. In the context of the assessment of 'effective supervision', this stakeholder suggested that ESMA may be able to take comfort from the IMF Financial Sector Assessment Program (FSAP) work.

6. Two stakeholders believed that:

   - a depositary should be first authorised by the competent authority to perform this function;

   - regarding the supervision on on-going basis, it should be performed on one hand by the competent authorities of the third country where the fund is domiciled and, on the other hand, by an external auditor which performs verifications on an annual basis;

   - the most relevant criteria in terms of equivalence should refer to the definition of functions performed by the depositary and to its level of liability in case of loss as defined in Article 21 of the AIFMD.

7. Two respondents encouraged ESMA to develop a list of equivalent third countries.

8. One stakeholder encouraged ESMA to take into consideration lessons from EU convergence of accounting standards of third countries with International Financial Reporting Standards (IFRS), in

particular, ensuring close and continuous co-operation with third country regulators in order to ensure workable outcomes.

9. One stakeholder believed that prudential regulation and supervision of a third country should be considered of the same effect as in the EU and effectively enforced if the third country:

   - Requires banks and investment firms that act as depositories to be authorised.

   - Has implemented the Basel II international capital adequacy standard. In this respect, it was noted that the capital adequacy requirements prescribed in Directives 2006/48/EC and 2006/49/EC were similar to the Basel II: International Convergence of Capital Measurement and Capital Standard, Revised Standard.

   - Is empowered by legislation to request information from the depository and to revoke the depository's license.

10. The same respondent explained that the Basel II standard, established by the Basel Committee on Banking Supervision, was the primary international standard for capital adequacy requirements for credit institutions and investment firms and that it had been widely accepted and adopted by Member States and many non-EU jurisdictions. According to this stakeholder, using Basel II as the standard of reference for the purposes of Article 21 of the AIFMD would provide a consistent and internationally recognised framework for assessing the equivalence of third country prudential regulations.

11. It was also recommended by one respondent that when determining the criteria for assessing the prudential regulatory and supervisory standards of a third country applicable to the AIF depositary, regard should be given to relevant international standards set by IOSCO. For the purposes of assessing compliance with such IOSCO standards, reliance should be placed on existing independent third party assessments of the third country (e.g. by the International Monetary Fund).

12. One respondent was of the view that the depositary located in a third country should comply with the following criteria:

   - The depositary is an entity regulated by specific local regulation on the activity of banks and custodians, imposing specific capital requirements, and specific guarantees (insurance guarantees or mutualised fund guarantee supervised by local authorities);

   - The depositary must be under the supervision of an official local authority supervising the activity of banks in the country where it is located.

13. The same stakeholder proposed that ESMA could make a list of entities eligible as depositaries in each third country in collaboration with their local authorities.

14. One respondent noted that for the purpose of determining whether the principles of the third country regime applicable to the prudential regulation and supervision of the relevant depositary entity were 'to the same effect' as the provisions of the Directive, the Commission invited ESMA to take account of whether the depositary entity was subject to rules 'as stringent as' those laid down in Article 21 of the Directive. This respondent did not consider that any assessment of whether entities in the relevant third country were 'subject to rules as stringent as those laid down in Article

21 of the Directive' was a valid interpretation of the Level 1 requirement for Level 2 measures to determine whether a particular third country regime was 'to the same effect' as the prudential regulation and supervision rules that apply to those entities that may act as the depositary of an EU AIF. According to this respondent, the Directive does not require there to be any express equivalence to Article 21 and suggested that the relevant criteria should fall into two key categories, namely qualitative and quantitative criteria.

**Qualitative assessment - Supervisory and enforcement powers**

15. Objective – To ensure that authorities responsible for the supervision of depositary undertakings possess adequate supervisory powers (including enforcement powers) and that these are properly exercisable. Criteria might include:

Ensuring compliance

- Ensuring compliance with laws and regulations.

Information obtainable from the undertaking

- Accounting, prudential, statistical and other information (e.g. contracts with affiliates, outsourcing arrangements, assessment of the quality of data received); and

- Accounting, prudential, statistical and other information (e.g. contracts with affiliates, outsourcing arrangements, assessment of the quality of data received)

Duty to report

- Breach of laws, regulations, administrative provisions;

- Issues which may affect the continuous functioning of the undertaking; and

- Refusal (or reservations) in respect of certification of accounts.

Non-compliance with legal provisions

- Measures to prevent/penalise further infringements including preventing the conclusion of new contracts

Enforcement

- Co-operation in respect of enforcement action

**Quantitative assessment - Financial supervision and resources**

16. Objective – To ensure that depositary undertakings act prudently in maintaining adequate financial resources in order to prevent disorderly failure. Criteria might include:

Capital adequacy requirements

- Relevant entities are subject to capital adequacy requirements meeting relevant international standards

17. For one stakeholder, as a matter of principle, criteria for assessing equivalence for non-EU depositaries should be as stringent as the provisions in Article 21 of the AIFMD concerning capital requirements and on-going supervision.

18. One respondent was of the view that Level 1 provisions were comprehensive enough and that therefore no implementing measures were necessary.

**Co-operation between EU and third country competent authorities for the purposes of Article 34(1), 36(1) and 42(1) of the AIFMD**

19. Several stakeholders supported the use of IOSCO and other international standards and also strongly recommended the publication of a central public database of details of the co-operation arrangements to allow easy identification by the AIFM of the relevant jurisdiction.

20. One respondent stressed that both ESMA and the European Commission should be fully aware of the very large number and variety of AIFs when developing detailed recommendations in this area.

21. One respondent supported the approach of not overextending the scope of the co-operation arrangements due to the non-binding nature and practical difficulties of implementing arrangements on a global basis, and believed that the key focus should be on achieving reporting frequency, level of details and consistency in format to improve the likelihood of successful capture and the cost-effective analysis.

**Co-operation arrangements between EU and non-EU competent authorities as required by Articles 35(2), 37(7)(d) and 39(2)(a) of the AIFMD**

22. Several stakeholders supported the use of IOSCO and other international standards and also strongly recommended the publication of a central pubic database of details of the co-operation arrangements to allow easy identification by AIFMs of relevant jurisdictions.

23. One respondent understood that the concern underpinning the request was focused on funds which employ leverage on a substantial basis and stressed any measures should recognise that not all 'hedge funds' were highly leveraged. Concerning the template, data format and the conditions of secure exchange, the same respondent was of the view that this issue was largely a matter for national competent authorities to comment on.

**Co-operation and exchange of information between EU competent authorities**

24. As this part of the Directive concerns exchange of information between EU competent authorities, ESMA and the ESRB, ESMA did not receive specific feedback on this issue.

**Member State of reference: authorisation of non-EU AIFMs – Opt-in (Article 37(4))**

25. One respondent believed that further discussion was needed to address the situation where a third country AIFM is an affiliate entity of a group with a pre-existing presence in the EU. This respondent was of the view that a simple reliance on the jurisdiction where the third country AIFM intends to conduct the majority of its marketing may not provide the optimal regulatory outcome in terms of supervision if the regulator in that jurisdiction was not the lead regulator for the group as a whole in the EU.

26. According to another respondent, the structure proposed in the AIFMD for determining a Member State of reference should be streamlined and clarified. For example, it was unclear for this respondent which Member State would become the Member State of reference for a non-EU AIFM intending to market a non-EU AIF in several Member States. The same stakeholder thought that the requirement to file applications with each potential Member State of reference significantly increases costs for the manager as well as for the regulatory authorities that receive the application. Finally, according to this respondent, the implementing measures should be structured taking into account the principles of non-discrimination set out in the recitals to the AIFMD.

27. The following process was also suggested:

- the AIFM formulates a single request in a prescribed form (appropriately translated) to be sent to multiple competent authorities;

- the AIFM may designate its Member State of reference at the time it makes the request; and

- on the expiration of the one-month deadline set out in the second subparagraph of Article 37(4), the AIFM's Member State of reference is automatically deemed to be the Member State of reference designated by the AIFM in its request unless the AIFM has been notified in writing of an objection by the relevant regulator of that Member State setting out the reasons for the objection.