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ESMA
103 rue de Grenelle
75007 Paris

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AFG response to ESMA discussion paper
on key concepts of the AIFMD and types of AIFM

The Association Française de la Gestion financière (AFG)[1] is grateful for the opportunity to respond to ESMA's discussion paper on key concepts of the Alternative Investment Fund Managers Directive (AIFMD) and types of AIFM.
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General comments

Please find below AFG general comments.

AFG supports ESMA's general aim to **avoid any circumvention** of the AIFMD (e.g. through the use of wrappers). Indeed, one of the main goals of the AIFMD is to reduce systemic risk. The approach should also ensure a level playing field among products/actors and among individual Member States, as those subject to the obligations of the AIFMD will incur higher regulatory and compliance costs. As far as possible, harmonisation among product/actors and among individual Member States should be ensured at EU level through ESMA's work on the exemptions to the AIFMD.

[1] The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. Our members include 425 management companies as of end January 2012. They are entrepreneurial or belong to French or foreign banking or insurance groups. AFG members manage 2,650 billion euros in the field of investment management as of end December 2011, making the Paris Fund Industry the leader in Europe for the financial management of collective investments (with over 1,550 billion euros managed from France, i.e. 20% of all EU assets managed in the form of investment funds) wherever they are domiciled in the EU. In the field of collective investment, our industry includes – beside UCITS – employee savings schemes and products such as regulated hedge funds/funds of hedge funds, private equity funds, real estate funds and socially responsible investment. AFG is of course an active member of the European Fund and Investment Management Association (EFAMA) and of the European Federation for Retirement Provision (EFRP). AFG is also an active member of the International Investment Funds Association (IIFA).

AFG would find it very helpful if ESMA highlighted in its workings that the criteria it proposes to define an AIF have to be looked at **jointly**: it is not because one of them is fulfilled that the structure under consideration can necessarily be defined as an AIF. **But, where all criterias defining AIFs are met jointly, it should be stated that these vehicles are considered as AIFs; therefore explicit exclusions – and not only the holdings exclusions - should not be used as a means to circumvent the provisions of the Directive.**

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Detailed comments

Please find below AFG detailed comments.

AFG comment on Point 10 page 7 of ESMA discussion paper

"Notwithstanding the fact that the AIFM may choose not to perform itself the additional functions set out in Annex I of the AIFMD, ESMA believes that in such a case these functions should be considered as having been delegated by the AIFM to a third party. Therefore, the AIFM should be responsible for the activities carried out by the delegated entity in relation to the functions set out under Annex I of the AIFMD, in compliance with both the rules on liability in case of delegation set out under Article 20(3) of the AIFMD and the principle expressed under Article 5(1) of the Directive according to which the single AIFM appointed for an AIF is responsible for the compliance with the AIFMD (i.e. also for the additional functions under Annex I)."

AFG members are concerned by this wording of point 10 of ESMA discussion paper which seems to imply that in case the AIFM does not perform them itself the additional functions that an AIFM may perform are considered as **automatically** delegated – implying that the responsibility lies on the AIFM.

In particular, we would like to highlight that regarding the function of "marketing", which is one of the functions that the AIFM "may additionally perform" as per Annex I of the AIFMD, *only* the activities described in Article 4 paragraph 1 (x) of the AIFMD are concerned i.e. "a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union". In other words, an AIFM that hires an entity to distribute the units or shares of an AIF it manages <u>on its behalf</u> is responsible for such distribution. Conversely, an AIFM that distributes the units or shares of an AIF it manages through a distributor cannot be held liable for such distribution. Also, extending the obligations of the Directive applying to EU manager in relation to the distribution of non EU funds in third countries, for example, would not make sense.

1. 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, AFG members see merit in clarifying further the notion of family office vehicles, even though this might prove a difficult exercise in practice.

In particular, they would like to clarify that recital 7 of the AIMFD does not prevent family offices from raising external capital such as bank loans. We would therefore suggest specifying that:

> "family offices do not raise external capital **from investors other than the family office investors**".

2. Do you see merit in clarifying the terms 'insurance contracts' and 'joint ventures'? If yes, please provide suggestions.

Yes, we would appreciate a clarification of the terms "insurance contracts" and "joint ventures".

Indeed, it would be very helpful if the authorities could elaborate on the exclusion relating to insurance. We do believe that activities in general – including contracts – should be excluded from the scope of the Directive. More generally we do support the general principle that wrappers (i.e. insurance products) should fall outside the scope of the AIFMD.

There is no legal definition at EU level of "joint ventures" and Member States may have different interpretations of this concept. Legal or contractual structures that exist in the EU are very diverse and drawing a line between those that are joint ventures or club deals and those that are not proves a very difficult task. Moreover, setting out a precise definition of "joint ventures" would probably go beyond the aim of the AIFMD.

However, setting out in the Directive characteristics identifying joint ventures would be helpful in order to identify the entities are out of its scope.

We believe that a joint venture has at least the following cumulative characteristics:

- its objective is to pool resources in a common goal defined by the investors when it is set up;
- it is controlled by the pooled actors i.e. the community of venturers / investors – rather than a fund manager – is responsible for making main decisions on the management of the assets;
- it has no investment policy.

3. 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 do see merit in elaborating further on the characteristics of holding companies. Indeed, this would help towards a more harmonised implementation of the Directive throughout the EU. We would welcome further work on this by the Commission or ESMA.

AFG comment on Point 15 page 8 of ESMA discussion paper

We do not fully agree with the definition of holding companies described in ESMA's discussion paper. Indeed, holding companies do not all have their shares admitted to trading on a regulated market in the EU. This would exclude from this definition, in turn including them in the scope of the AIFMD:

- holding companies whose shares are not admitted to trading on any regulated market in the EU and
- holding companies whose shares are admitted to trading on markets outside the EU.

We therefore suggest limiting ESMA's proposed definition to the following:

> "companies with shareholdings in one or more other companies, the commercial purpose of which is to carry out a business strategy or strategies through subsidiaries, associated companies or participations".

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

AFG members would like to highlight the fact that the different exemptions should articulate smoothly. Indeed, a joint venture may take the form for example of a holding company or of a family office and the provisions applying to these exemptions should be compatible.

They are also concerned about the wording of paragraph 16 page 8 of ESMA discussion paper which states that "the explicit exclusion of holding companies should not be used as a means to circumvent the provisions of the Directive". Indeed, holding companies may not be the only vehicle that might be used to circumvent the AIFMD. **It should be ensured that explicit exclusions – in general - should not be used as a means to circumvent the provisions of the Directive. Where all criterias defining AIFs are met jointly, it should be stated that these vehicles are considered as AIFs.**

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

Yes, AFG members generally agree with the orientations set out by ESMA on the content of the criteria extracted from the definition of AIF.

However, one AFG member believes that the criteria set in point 26 page 10 relating to "raising capital" and point 33 page 11 relating to the ownership of underlying assets seem too large as they could apply to any financial instrument or any company. It is indeed worth noting that ESMA highlights in point 27 that fulfilling the criterion described in point 26 would not be "conclusive evidence that an entity is not an AIF". We understand that the criteria proposed by ESMA in order to define an AIF are to be looked at jointly: it is not because one of them is fulfilled that the structure under consideration can necessarily be defined as an AIF.

Our member also believes that the criterion set in point 28 page 10 relating to "collective investment" is incorrect as the purpose of a closed-ended fund may be to generate value during the life of the undertaking. It therefore suggests limiting the definition to the following:

> "An AIF for the purpose of the Article 4 must be a collective investment undertaking which pools together capital raised from investors".

AFG comment on Point 20 page 9 of ESMA discussion paper

We welcome ESMA's effort to map the different categories of AIFs currently existing in the European market. In the context of this exercice, we would like to point out the existence of non

UCITS funds that are not labelled as UCITS for the simple reason that their managers decided not to use the passport.

One AFG member notes that the description of alternative investment funds might stigmatise certain assets and suggests amending it as follows:

> "Alternative investment funds investing in a wide variety of assets including […] **or strategies such as long short, arbitrage, market neutral or event driven**".

6. Do you have any alternative/additional suggestions on the content of these criteria?

No, we do not have any alternative / additional suggestions on the content of these criteria.

However, in relation to the application of the principle of proportionality as provided by Article 16, we would like to draw ESMA's attention to the fact that "unleveraged" AIFs are not explicitly defined by the AIFMD.

7. Do you agree with the orientations set out above on the notion of raising capital? If not, please provide explanations and an alternative solution.

Yes, we agree with the orientations set out above on the notion of raising capital.

8. 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?

We consider that co-investment by the manager or by individuals or other entities closely connected with the manager should be ignored when determining whether an entity raises capital from a number of investors.

Moreover, we believe that ancillary investors – only required to set up the structure – should not be taken into account when determining whether or not an entity raises capital from a number of investors.

9. 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 do agree with the analysis on the ownership of the underlying assets in an AIF.

10. 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.

Yes, we do agree with the analysis on the absence of any investor discretion or control of the underlying assets in an AIF – as far as the AIF governance ensures that the interests of the AIFM are in line with those of investors.

11. 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 generally agree with ESMA's proposed definition of open-ended funds. However, we would like to specify that:

> "the units /shares of open-ended funds may be at the holder's request, repurchased or redeemed without limitation **agreed that as clearly described in the fund's documents for instance gate mechanisms may be put in place** […]".

Indeed**,** some AFG members foresee the use of gates in their liquidity management toolkit described in the prospectus of the AIFs they manage. In our members' view, these tools, provided that they are disclosed in the prospectus, should not be considered as special arrangements nor automatically characterise a fund as closed-ended (please refer to AFG response to ESMA consultation on possible implementing measures of the Alternative Investment Fund Managers Directive dated 13 September 2011, p.14).

In other words, the use of certain liquidity management tools should not prevent open-ended funds to be defined as such.

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

The AIFMD allows for 3 definitions and thus 3 calculation methods of the leverage used by AIFs. For any given fund, each calculation will end up with a different figure. So, it is obvious that what is important is not the leverage figure as such but the leverage figure in conjunction with the methodology used. As a matter of fact, the methodology creates a reference framework within which each result has to be interpreted and analyzed in terms of risks being generated by the strategy implemented in the fund concerned. This means that for one given fund, each methodology will produce a result different from the other while the main conclusive actions, if any, should be the same. Marginally, each framework may shed light on a particular aspect of interest to the fund management and possibly to its supervisors. But these specifics will not have any impact whatsoever on the fact that the leverage is significant or not.

So "significant" does not sit at the same intrinsic level for the different methodologies. Now, for one given methodology, when can a level of leverage be deemed significant and what types of actions such "significance" could trigger?

The objective of regulators is the prevention of systemic risks, bearing in mind that the passport deriving from the Directive applies to professional investors. There are warning signals to leverage levels becoming systemically dangerous.

The danger is proportionate with the size of the assets under management concerned; so, AIFs should be reviewed according to their size and to their leverage (simple matrix) and then relevant aggregate figures could be considered. Shifts in the level of leverage should be identified (reporting and controls) in order to provide early warning signals.

The next layer of complexity lies in the fact that leverage is more "natural" with, for example, low-margin types of strategies and that the analysis of the leverage has to take this point into account at

the AIF level. The consequences on the system of a fall down of an AIF with high leverage are not the same for all AIFs and are linked to their type of strategy and underlying assets. Indeed, leverage should be appreciated with regards to the liquidity of the underlying assets in the portfolio of the AIF, bearing in mind that such liquidity might change over time. Consequently, any intervention has to be tailored to the characteristics of the funds. Furthermore, actions cannot be defined in absolute terms as they could have second order consequences that have to be considered upfront.

In any case, AFG would like to recall that the choice of the calculation method should be up to the manager, which will be in a position to pick for each AIF it manages the calculation method most suitable to the profile of the AIF.

We strongly oppose the use of the gross method of calculating the leverage. It would be misleading if disclosed to **investors** as it would not allow for comparisons with UCITS - which use other calculation methods.

At worst, the disclosure of the gross leverage should be limited to **regulators only**, in the context of monitoring systemic risk, at least in order not to mislead investors.

We however do strongly support that the AIFM itself should be responsible for setting a maximum level of leverage which they may employ on behalf of each AIF they manage. We would like to reassert that the competent authorities of the home Member State of the AIFM should carefully consider the potential consequences of imposing limits to the leverage of an AIF (such as forced sales) before they decide to do so (please refer to AFG response to ESMA consultation on possible implementing measures of the Alternative Investment Fund Managers Directive dated 13 September 2011).

AFG comment on Point 38 page 13 of ESMA discussion paper

In order to improve the accuracy of ESMA's proposal, we suggest rewording as follows:

> "a determination must be made as to whether the AIF it manages is leveraged (~~included~~ **and if so** whether leverage is employed on a substantial basis)"

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

AFG members do support ESMA's view that AIFMs which are also UCITS management companies should be able to carry out receipt and transmission of orders under their AIFMD authorisation, provided conflicts of interest are taken into account.

Regarding the provision of information to authorities for authorisation purposes, we believe that there would be no use in management companies that already are authorised by their competent authorities – for example as UCITS management companies – to provide them again with all the information relating to the AIFM authorisation process. Rather, we think that it would be more efficient, for both management companies and regulators, to provide only the additional information required by the new legislation and if relevant any update of the information already provided. This is indeed the approach taken by the Directive with respect to asset management companies that already are authorised as UCITS management companies.

AFG comment on Point 49 page 14 of ESMA discussion paper

One AFG member suggests specifying that the services that a UCITS management company may provide to AIFs are those listed in Annex I of the AIFMD.

More generally, AFG believes that it should be ensured that the AIFM does not delegate its functions to the UCITS management company to the extent that it becomes a letter box entity.

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

AFG supports the provision of article 6 paragraph 4 that allows Member States to authorise AIFMs to provide certain "MiFID" services namely management of portfolios of investment in accordance with mandates, investment advice, safekeeping and administration and RTO. We strongly believe that AIFMs should be able to perform and benefit from a passport for these activities.

However, we believe that MiFID licensed firms (e.g. banks, brokers) should be forbidden to perform the activities specific to AIFMs or UCITS management companies. Indeed, it is crucial that the specialisation of activities should be maintained and the exclusivity of collective investment management for fund management companies should be preserved for the sake of preventing conflicts of interests which might very easily arise from extending MiFID licensed firms scope of activities to collective investment management.

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If you need any further information, please do not hesitate to contact our Head of International Affairs Division, Stéphane Janin, at +33 1 44 94 94 04 (s.janin@afg.asso.fr), our Deputy Head of International Affairs Division, Carine Delfrayssi, at + 33 1 44 94 96 58 (c.delfrayssi@afg.asso.fr) or myself at +33 1 44 94 94 29 (p.bollon@afg.asso.fr).

Sincerely yours,

(Signed)

Pierre Bollon