

Second ESMA Consultation Paper on the Alternative Investment Fund Managers Directive – Supervision and Third Country Entities

On 23 August 2011, the European Securities and Markets Authority ("ESMA") released its second draft technical advice on possible implementing measures in respect of the Alternative Investment Fund Managers Directive ("AIFMD"). It deals with implementing measures in respect of (i) delegation of portfolio management and risk management functions to third country entities, (ii) assessment of equivalence of third country depositary frameworks and (iii) supervisory co-operation and exchange of information in relation to marketing non-EU AIFs and EU AIFs managed by non-EU AIFMs. This second consultation paper follows a first consultation paper which was published on 13 July 2011 and covered a much wider range of topics.

The attached table sets out the highlights of the second consultation paper.

This second draft advice is helpful in many respects. It suggests using international standards to assess equivalence of third country regulation and supervision rather than creating an additional layer of EU rules. It also sees a role for ESMA and the EU Commission in facilitating the assessment of equivalence. The main contribution of the draft however lies in the tools ESMA suggests to accomplish the near impossible task of putting in place all the required arrangements for cooperation and exchange of information by 2013.

Arrangements for cooperation and exchange of information by 2013?

The passport for marketing AIFs across the EU to professional investors was subject to fierce political debate during the negotiation of the AIFMD. The solution reached consists of (i) the creation of a passport as of July 2013 for EU AIFMs, (ii) a marketing regime without passporting rights for those entities not benefitting from the passport in 2013, and (iii) a procedure to consider by 2015 extending the passport to non-EU non-AIFMs in 2015.

The marketing regime without passporting rights relies heavily on the existence of co-operation agreements between all relevant regulators by 2013. Having all co-operation arrangements in place between all relevant regulators by 2013 seems however like an enormous challenge. A multitude of both third party regulators and member state regulators will need to negotiate technical arrangements on cooperation and exchange of information at a moment when the regulatory agenda is already crowded. As a consequence, some market participants doubt whether regulators will be able (or willing) to put all arrangements in place by 2013. In the absence of these arrangements, marketing non-EU AIFs and AIFs managed by non-EU AIFMs in the EU could become complicated or even impossible.

ESMA's proposals on the co-operation arrangements provide useful tools to deal with this challenge:

- actors - instead of having individual national regulators negotiating with third country regulators, ESMA proposes to negotiate the co-operation agreements centrally;

Key Issues

- (Sub-) Delegation of portfolio management and risk management functions outside of the EU
- Appointment of non-EU depositaries
- Co-operation and exchange of information for marketing of non-EU AIFs or EU AIFs managed by non-EU AIFMs
- Non-EU AIFMs – Member State of reference

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- contents - the contents of the co-operation arrangements can be based on a template co-operation arrangement established by ESMA at EU level. The template would be inspired by the IOSCO Multilateral Memorandum of Understanding of May 2002 and the ISOCO Technical Committee Principles for Supervisory Co-operation;
- execution - agreements should be executed as joint agreements between all regulators involved.

AIFMD Level 2

This consultation paper follows a first consultation paper published by ESMA on 13 July 2011. The first paper dealt with implementing measures in respect of exemptions to the AIFMD, authorisation requirements, operating conditions, depositary obligations and requirements in respect of transparency and leverage.

The two consultation papers are the first steps in the process of putting in place approximately one hundred Level 2 implementing measures, technical standards and guidelines under the AIFMD. These implementing measures, technical standards and guidelines are needed to give concrete shape to the general provisions and principles set out in the AIFMD.

Next steps

The consultation period for this second consultation paper closes on 23 September 2011 (the consultation period for the first consultation paper closes on 13 September 2011). ESMA intends to submit its consolidated advice to the EU Commission by 16 November 2011.

In the attached table we briefly set out some highlights of the consultation paper.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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AIFMD rule	ESMA Proposal	Comment
(Sub-) delegation of portfolio management and risk management functions outside of the EU		
<p>(Sub-) delegation requires that</p> <p>(i) the (sub) delegate is</p> <ul style="list-style-type: none"> • authorised or registered for the purpose of asset management; and • subject to supervision, <p>If this condition is not complied with, prior approval by the AIFM's regulator will be required.</p> <p>(ii) cooperation exists between AIFM regulator and (sub-) delegate regulator</p>	<p>(i) <i>(sub-) delegate</i></p> <ul style="list-style-type: none"> • authorisation/registration – requirement: deemed satisfied when local authorisation/registration criteria are equivalent to EU criteria. Equivalence should be assessed by comparing the eligibility criteria and the on-going operating conditions locally applicable against the corresponding requirements applicable in the EU. • supervision – requirement: deemed satisfied when an independent regulator exercises effective supervision. Independence to be assessed in light of IOSCO and Basel Committee standards but no need for third country to be a member of these organisations. Regulator should have powers to obtain information and to enforce regulation. <p>(ii) <i>Cooperation between regulators</i></p> <ul style="list-style-type: none"> • co-operation arrangement: existence of a written arrangement between competent authorities of the AIFM and delegate needs to be in place prior to start of (sub-)delegation • contents of arrangement: arrangement should entitle the AIFM's regulator to: obtain information necessary to supervise; obtain access to relevant documents, have a right to request and perform on-site inspection, obtain information and conduct enforcement in case of breach of regulations. 	<p>ESMA's proposal seems to go further than what is required under the AIFMD by including reference to on-going operating conditions.</p> <p>The reference to international standards is helpful and avoids an additional layer of EU specific standards on assessment of independence of regulator.</p> <p>Helpful suggestion that arrangements can take form of MMoUs centrally negotiated by ESMA. This would ensure a level playing field and avoid a multitude of bi-lateral arrangements</p> <p>Contents should be based on international standards, and in particular, the IOSCO MMoU concerning consultation and co-operation and the exchange of information of May 2002 and the IOSCO Technical Committee Principles for Supervisory Co-Operation.</p>
Appointment of non-EU depositaries		
<p>Depositary will need to be subject to</p> <p>(i) effective prudential regulation, including minimum capital requirements;</p> <p>(ii) effective supervision which has the same effect as EU law;</p>	<p>(i) <i>Effective regulation</i></p> <p>Local regulatory framework for depositaries needs</p> <ul style="list-style-type: none"> • to be equivalent to EU framework for credit institutions and investment firms, i.e. eligibility criteria to act as depositary, capital requirements and operating conditions; and • to set out specific depositary duties equivalent to those set out in the AIFMD. 	<p>Useful suggestion to provide possibility for EU Commission to verify compliance with criteria and issue decisions as to equivalence of third country jurisdictions</p>

AIFMD rule	ESMA Proposal	Comment
(iii) effectively enforced prudential regulation	(ii) <i>Effective supervision</i> <ul style="list-style-type: none"> • Ongoing supervision by an independent competent authority with adequate resources to fulfil its tasks. Independence to be assessed in light of IOSCO and Basel Committee standards but no need for third country to be a member of these organisations. (iii) <i>Effective enforcement</i> <ul style="list-style-type: none"> • Sufficiently dissuasive sanctions • Liability to the investors of the AIF can be invoked 	The reference to international standards is helpful and avoids additional layer of EU specific standards on assessment of independence of regulator.
Co-operation and exchange of information for marketing of non-EU AIFs or EU AIFs managed by non-EU AIFMs		
Appropriate cooperation arrangements between relevant regulators are required in order to ensure at least an efficient exchange of information to allow relevant EU regulator to carry out its duties under the AIFMD	(i) <i>Cooperation arrangement</i> Co-operation arrangement in writing to be entered into between relevant third country regulator and relevant national regulator(s) (ii) <i>Contents of cooperation arrangement</i> <ul style="list-style-type: none"> • exchange of information for supervisory and enforcement purposes; • right to obtain all information necessary to perform duties under AIFMD; • right to request on-site inspection or perform on-site inspection; • assistance of EU regulators by third country regulator with enforcement of EU and national legislation; • systemic risk information on on-going basis if required. 	Helpful suggestion that arrangements could be based on a template established by ESMA at EU level. Where several national regulators are involved, arrangement could be signed as joint agreement between all regulators involved. Contents should be based on international standards, and in particular, the IOSCO Multilateral with respect to co-operation of enforcement purposes and for supervisory purposes, IOSCO's Technical Committee Principles for Supervisory Co-operation.
Non-EU AIFMs - Member State of reference		
In case of non-EU AIFM, several rules exist to determine "Member State of Reference".	No need to identify additional criteria to those set out in the AIFMD. More detailed procedure is proposed in case of conflict between competent authorities of several Member States. Role for ESMA to participate in process.	Procedure is more streamlined and involvement of ESMA could facilitate solution.