

January 29th , 2010

Proposals relating to the Gauzès Report on the AIFM Directive (AIFMD)

These proposals for adjustments to the Gauzès report on the AIFM Directive have been drafted by Eurofi with the input of a group of representative asset managers, custodians, valuers, prime brokers and insurance groups operating in the EU. Their objectives are to better take into account certain operational constraints and improve the allocation of responsibilities in the requirements of the Directive while maintaining its coherence and initial objectives.

The following players contributed to this initiative: Amundi Asset Management (formerly Crédit Agricole AM), AXA Investment Managers, The Bank of New York Mellon, BNP Paribas Investment Partners and Securities Services, CACEIS, Citi, Deutsche Bank, Fidelity International, Goldman Sachs, JP Morgan, Hedge Fund Standard Board (HFSB), MidEuropa, Pioneer, Prudential, Société Générale and Union Investment.

Obligations of the AIFM:

Principles of proportionality set out in the AIFM directive for small AIFM should be completed to avoid unnecessary or inapplicable constraints being imposed on certain types of AIFs, insofar as this does not undermine the Directive's capacity to improve systemic risk management and the protection of professional investors. We have sought to propose differentiation measures to adjust the requirements of the Directive for generic and clearly identified types of funds (e.g. closed-ended AIFs, closed-ended AIFs whose units may not be sold for several years, AIFs created especially for a limited number of institutional investors, AIFs traded on the stock market, AIFs investing in non marked-to-market assets, etc...), rather than for specific fund categories (such as private equity funds, certain domestic fund categories, etc...) to avoid issues in terms of definitions and consistency in the Directive.

For corporate AIFs which are companies owned by the investors and managed under the responsibility of a Board of Directors, the body to which AIFM requirements apply to should be clarified as being the entity which performs the substance of the investment management function. The specific responsibilities of the Board of Directors should however also be accounted for (ie appointing service providers including the valuator and the depositary, deciding on the issue of new shares...).

Concerning the rules proposed in the Gauzès report for funds of funds investing more than 30% in non-EU AIFs:

- We believe that setting a rule in the AIFMD to forbid the distribution of this type of fund to retail investors in domestic markets is not consistent with the objective of the AIFMD which is to define EU rules for professional investors in AIFs. A consistent level of protection of retail investors in the EU, in addition to what is provided in domestic frameworks, would be better obtained by a specific EU framework for AIFs sold to retail investors covering a broader range of investment rules.
- The proposal to impose limitations to the passporting of such funds to professional investors goes beyond the initial aim of the amendment proposed in the Gauzès report, which presumably was to prevent a non-passportable non-EU AIF from simply being repackaged as an EU fund of funds in order to benefit from a passport. Most participants in our group

suggest modifying the amendment to prevent the passporting of funds of funds which invest significantly ie more than 30% in **another** non-EU AIF (rather than 30% in non-EU AIFs).

AIFs for which a passport is granted under the prospectus directive (closed-ended funds) before the AIFM Directive comes into force should be able to continue benefiting from this passport after the AIFMD has been implemented. However, all AIFs issued after the AIFM Directive takes effect will then need to comply with its distribution requirements.

With regard to delegation arrangements, we propose that asset management and risk management could be delegated to non-EU AIFMs adequately regulated and supervised with standards that meet those applying to EU AIFMs, which is coherent with MiFID and UCITS rules. The competent national authority of the AIFM should be notified of such delegation arrangements. We believe that sub-delegation should also be possible, if it follows rules that are identical to those for delegation.

The delegation of administrative functions by AIFMs to depositaries or to other administrative agents should also be authorised insofar as the AIFM keeps responsibility for these delegated functions.

The directive should specify more explicitly that an AIFM's main activity can include not just the management of AIFs but also portfolio management activities defined by MiFID.

If changes are brought to an AIF's investment strategy, the AIFM should be able to implement these changes in parallel with the notification procedure to the authorities if these changes do not substantially modify the conditions under which the AIFM's authorisation was obtained, to simplify the management of AIFs which require regular changes in their investment strategy in agreement with the investors.

Putting specific rules in place for short selling in this Directive seems premature, since CESR and the Commission have not yet published their final recommendations in this area. Possible inconsistency with rules proposed for a broader range of financial instruments should be avoided. However, the AIFM should be required to apply the rules once they have been established for all financial instruments concerned.

Obligations of the depositary and of the valuator:

The way the depositary's duties and liabilities are defined in the AIFMD must provide sufficient protection for professional investors without making depositaries liable for risks they cannot control, which requires that risks and responsibilities be properly allocated.

The standard of responsibility set out by the Gauzès Report goes in the right direction. If assets held in custody by the depositary are lost or cannot be recovered, the depositary should return these assets, unless proof can be brought that it has adequately performed its duties of due diligence and control of the sub-custodians concerned. The depositary should not be held liable for losses due to events out of its control (ie defaults of players which it has not appointed or that it is obliged to use eg CSDs or cases of "force majeure").

Responsibilities must be clearly defined when custody is delegated:

- The duties depositaries should perform in case of delegation of custody should be further specified (i.e. selecting and monitoring their sub-custodians) and more specific rules should be set out at Level II for conducting these activities.
- The custody of assets can be delegated, but not the selection and monitoring of sub-custodians, which the depositary must remain responsible for, in the same way as the oversight of the AIF
- The players who have taken the delegation decision should be responsible for the delegates they have appointed and remain liable for them. In this respect, prime brokers which are selected by the AIFM or the fund (in the case of a corporate fund) for example cannot be considered as delegates or sub-custodians of the depositary, but rather as delegates of the AIFM or of the Board, depending on the structure of the fund (ie contractual or corporate).

The obligation to return assets that have been lost or cannot be recovered in the event of proven failure by the depositary must intervene within a timeframe that allows any legal or administrative procedures (eg related to insolvency laws) to be completed. Before such procedures are finalised, the assets cannot be considered to be lost. Assets must therefore be returned without “undue” delay once it has been confirmed that assets cannot be recovered, further to the various proceedings.

It must be possible to depart from this standard responsibility regime through contractual agreements between the AIFM and the depositary, which may introduce modifications of the contents of liabilities or of the conditions or delays for restituting assets in the event of a default. These agreements must be disclosed to investors before the investment, as well as to the competent regulator, in order to ensure their legal validity.

The list of eligible players who may serve as depositaries should be extended to include companies that are not credit institutions or MiFID regulated firms but that are adequately regulated and can provide equivalent guarantees. This will enable companies which are currently performing the depositary role, and which can offer sufficient guarantees (by way of example certain trustees based in the UK or Ireland) to continue with their activities.

The respective roles played by the AIFM and the depositary in valuation must be specified: the AIFM must be responsible for the effective performance of the valuation, with the depositary remaining responsible for verifying that the NAVs are being prepared appropriately by the AIFM and its delegates, as part of its oversight responsibilities.

The Commission should be invited, in the AIFM Directive, to review the duties and responsibilities of UCITS depositaries before the AIFM Directive is implemented, in order to prevent the duties of AIF depositaries from being more precise or stricter than those of UCITS depositaries, which are meant to bring higher safeguards to retail investors. Nonetheless, the responsibilities defined for depositaries in the AIFMD must not be exported directly into the UCITS Directive without being reviewed beforehand, since the specific characteristics of professional investors should be taken into consideration in the AIFMD.