Submission

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On behalf of the Public Affairs Executive (PAE) of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

23 March 2012

To	**ESMA**
Re	**Response to ESMA's Discussion paper on 'Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM' (ESMA/2012/117)**

Introduction

We write to you on behalf of the representative national and supranational European private equity bodies. Our members cover the whole investment spectrum, from venture capital firms investing into high growth technology start-ups, to the largest global buyout funds turning around and growing mature companies, and we speak on behalf of the entire European private equity and venture capital (PE/VC) industry.

The European PE/VC industry welcomes the opportunity to respond to the Discussion Paper on 'Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM', published by ESMA on 23 February 2012.

The questions put forward by ESMA have been highlighted in bold and boxed out. The industry's responses are set out in normal type.

We have a number of comments on matters which either were not directly raised in the Discussion Paper or were raised but without questions linked to the relevant sections (notably in relation to the definition of an AIFM and its activities). We have added our comments on these additional matters at the end of this paper and we trust that ESMA is willing to consider them.

The European PE/VC industry remains, as ever, committed to an ongoing dialogue with policy officials and interested stakeholders, and welcomes any comment on its response to the discussion paper. In this respect, we would particularly welcome the opportunity to meet with ESMA to explain and discuss our thoughts in more detail.

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IV. Definition

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

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

EVCA Response:

Family office vehicles are only one example of a situation in which the private wealth of investors is invested without raising external capital. There are a number of other situations where no external capital is raised and it is instead only a matter of coming together to invest private wealth. We believe that the raising of external capital is a central feature of an AIF and that ESMA should make it clear that this is the case. This general point is addressed further in questions 2 and 7 below.

As far as the specific example of family office vehicles is concerned we do not think there is merit in seeking to define the notion more precisely. The concept is well recognised and such vehicles are generally readily recognisable. However the various types of family relationship which may be covered are very extensive, particularly when long established and multi-generational. There can be relationships of blood or of law (marriage, adoption etc). They frequently include investment by trusts, family companies and other vehicles, as well as by individual family members and beneficiaries may include charities as well as family members. Families may join together. Families and the vehicles they use can take all forms and structures and are so special that it is impossible to further define the term without risking unintentionally bringing some family office vehicles into the scope of the Directive. All of these arrangements should be regarded as investing the private wealth of investors without raising external capital and should fall within the exclusion.

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

EVCA Response:

In most Member States the legal definition of an insurance contract is complex and long established. That definition underlies a wide range of law and regulation in each Member State. It was not thought necessary to define the term for the purposes of the Insurance Directives and it would not be appropriate to seek to define it for the purposes of the AIFM Directive.

We regard a joint venture as another situation in which external capital is not raised but instead the parties come together to achieve a common goal by bringing together their relevant resources (normally a mixture of financial or other assets and expertise, though parties to the joint venture may contribute in different ways and proportions). We think it would be unwise to seek to define or clarify the commercial (non legal) term "joint venture" because there is such a wide range of commercial arrangements entered into which could be affected, and too narrow a definition is therefore likely inadvertently to damage normal corporate business activities in the real economy. If such term were to be defined then an indication for a joint venture is often that investors are involved on certain key decisions.

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

EVCA Response:

We note that ESMA expressed concern that the definition of a holding company might be used to circumvent the Directive. Where the legislator has defined the scope of the AIFMD to exclude holding companies, as defined in the Directive text, we do not think that it can be regarded as a matter of circumventing the Directive.

We also do not believe that there is any significant ground for ESMA’s concern, bearing in mind that the excluded type of entity must have the commercial purpose of carrying on a business strategy or strategies through its subsidiaries, associated companies or participations in order to contribute to their long term value. This seems to be very close to the ideas expressed by ESMA in paragraph 28 of the Discussion Paper (with which we agree) contrasting a collective investment undertaking (which should have the purpose of generating a return for its investors through the sale of its investments) with an entity acting on its own account whose purpose is to manage the underlying assets with a view to generating value through the life of the undertaking.

A private equity or venture capital fund has as its purpose the generation of a return for investors through the creation of value and the ultimate sale of its investments. It will normally seek to achieve that return by assisting the investee companies in carrying out their business strategies in a way which contributes to their long term value, thus making them capable of sale at a higher price, but the purpose of the fund is the investment purpose of generating a return from sales of interests in the investee companies, not the commercial one of carrying out the business strategies of the investee companies. Investment structures will be set up, and investee companies segregated from one another in order to make sales easier to achieve in future. The legislator’s definition appears to us to be a correct exclusion in line with ESMA's views as expressed in paragraph 28. Moreover it is sufficiently precise so that any further clarification or elaboration is likely to be confusing.

There are, however, a couple of minor clarifications which might be desirable and which should not generate confusion. The first is that we assume the term holding “company” should be regarded as covering all types of holding entity or vehicle which meet the defined criteria (e.g. LLPs, limited partnerships or even entities which may be subject to another regime, e.g. Luxembourg SOPARFIS). The second is that entities which are in company law terms normally described as holding companies but which would not meet other criteria of the definition of an AIF (e.g. because they do not raise external capital or do not have a defined investment policy) do not need to rely on the specific holding company exclusion. This would be the case in relation to the acquisition vehicles which a private equity or venture capital AIF, or its AIFM, put in place in order to acquire the underlying investee company and keep it segregated from other portfolio companies in order to facilitate future sale.

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

EVCA Response:

We think the other exclusions and exemptions are generally sufficiently clear or at least, as in the case of securitisation vehicles, fully addressed in the Directive text and its cross reference. It might be possible to clarify the reference to employee savings and employee participation schemes a little further by recognising that the definition of employee in such schemes generally needs to be broadened to include personnel of the relevant undertaking who are not necessarily employees as a matter of employment law (e.g. directors, officers, members of an LLP) and in each case close relatives and trustees.

The group exemption should clearly include indirect subsidiaries (as is the case for the equivalent MiFID exemption). We would just note that once again for this exemption to become relevant it is necessary for the vehicle concerned to all fulfil the other criteria for being an AIF. If it does not do so then it will not need to use the group exemption and it will therefore not be relevant whether one of the group participants is itself an AIF.

4. Proposed Criteria to identify an AIF

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

EVCA Response:

We note the inconclusive nature of the mapping exercise carried out by ESMA outlined in paragraphs 20-23 and would only comment in relation to it that:

a) private equity funds frequently invest in small companies and may provide development capital at all levels;

b) venture capital funds invest beyond start ups, and existing and medium sized firms can still need significant venture funding;

c) both private equity and venture capital funds, though more frequently the latter, invest in life sciences.

We agree with most of ESMA's views on the criteria extracted from the definition of AIF and set out below our detailed comments on those criteria in the order given by ESMA:

Raise Capital

We agree with paragraphs 25 and 26 and in particular that in order to constitute an AIF there needs to be:

- commercial reasons intended to deliver an investment return or profit to the investors

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- a positive capital raising involving a communication by way of business between the entity seeking capital or someone acting for it and the prospective investors which results in the transfer of investors cash or other assets to the AIF.

We would elaborate on the ideas put forward by ESMA as follows. We believe that "raising capital" must involve a person (who might be termed a "sponsor", but who may or may not be the AIFM, and may or may not itself be an investor or otherwise a participant in the fund) taking active steps by way of business to procure the commitment of third party (i.e. external) capital (which commitment must be more than merely nominal) with a view to the sponsor, or someone affiliated with the sponsor, making a profit (which could be income or capital gains but which must be more than merely nominal or de minimis) from the management of capital raised from the third (or external) party .

Illustrating this concept in the private equity context, it is typical for certain senior executives of the AIFM to participate in a "carried interest" vehicle. Typically, the carried interest vehicle will be a limited partnership, which is itself a limited partner in a main fund limited partnership (i.e. the true AIF), alongside third party investors. The purpose of the carried interest limited partnership is to regulate the rights of the executives amongst themselves. In order to establish the carried interest limited partnership, and in order for the executives and the general partner to become partners, it is likely to be necessary for each of them to make a modest capital contribution. The general partner of the carried interest limited partnership or any external administrator or manager would not do more than cover its costs in relation to that partnership. Any profit made would be in relation to the main fund partnership (which has external third party investors). In these circumstances, we do not believe that there is any "capital raising" in respect of the carried interest limited partnership. The purpose of establishing the vehicle is not for the general partner or manager of the carried interest limited partnership to receive profits from the capital contributed by the limited partners. In other words, there is no relevant "sponsor" (see above). In addition any capital contributed should not be regarded as external or third party capital because it is contributed by persons connected with the general partner or manager. On both these basis, the carried interest vehicle would not be a second AIF.

The same vehicle or a different vehicle may also be used to effect executive co-investment in transactions alongside the AIF. This would require the executives to commit capital which is more than merely nominal. In this case, for the same reasons, we consider the vehicle would still not be an AIF, either because the general partner or manager was still only recovering costs or because there is no raising of "external" capital, on the assumption that the only investors in the carried interest/co-investment vehicle are executives of the private equity firm, or members of their family.

We believe that these would be appropriate policy outcomes since the only true "fund" limited partnership, that is the one with external third party investors who require the protections of the Directive, will be treated as an AIF. Vehicles solely for participation by those connected with the manager in order to align their interests with the third party investors will not be treated as AIF.

We should note that there are two further policy reasons for excluding carried interest and management co-investment vehicles. The first is the exclusion of employee savings and participation schemes, which may encompass such arrangements. The second is that certain types of carried interest arrangement and grants of interests in an AIF are treated for the purposes of Annex II to the Directive as a form of remuneration to the executives of the AIFM. It seems inappropriate to treat the same thing *for the purposes of the Directive* both as a remuneration scheme, and as an AIF. (We note that carried interest is not "remuneration" in the ordinary sense, this is a special provision in the Directive.)

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However the principal reason why we do not consider that carried interest and co-investment partnerships are AIF is the absence of the raising of capital, or external capital.

We disagree strongly with the conclusion in paragraph 27 that the absence of capital raising is not conclusive evidence that an entity is not an AIF and believe that it is wrong as a matter of law. There are very few elements to the definition of an AIF in Level 1. It is inappropriate to dismiss one key ingredient as inconclusive and we do not believe that ESMA, or any other body has power to remove an element of the Directive definition in this way.

However, we agree that, in some circumstances, indirect capital raising may be covered in order to prevent abusive avoidance. The example which ESMA gives may, depending on the circumstances, be a case of such indirect capital raising. If, for example, the investors who originally invested in the first (liquidated) AIF received interests in the new entity formed to receive some or all of its assets in return for the transfer of assets to the new entity, which we assume is the situation ESMA envisages, we think there would have been indirect capital raising for the new entity sufficient to make it an AIF. If the new entity itself raised funds to make the acquisition of those assets on the basis of a defined investment policy that would be a direct capital raising and by the new entity and again it would be an AIF. If, however, an existing company formed a new subsidiary in order to purchase assets from the first (liquidated) AIF without raising further capital and the cash it paid for those assets was distributed to the investors in the liquidation of the first AIF we do not think there would have been any capital raising (direct or indirect) sufficient to make the acquiring company an AIF.

Finally we note that in the Directive definition the capital must be raised “with a view to” investing it in accordance with a defined investment policy “for the benefit of” those investors. We believe this linking of the capital raising to both:

- investing in accordance with the defined investment policy; and
- that investment being for the benefit of those investing the capital raised

is very important and should not be overlooked. It is helpful to draw out the individual elements of the AIF definition but their interrelationship is also crucial to the definition.

Collective investment

In relation to private equity and venture capital funds we support the conclusions in paragraph 28 that:

- an AIF must be a collective investment undertaking which pools together capital raised from investors
- a collective investment undertaking should have the purpose of generating a return for its investors through the realizations of its investments as opposed to an entity acting on its own account whose purpose is to manage the underlying assets with a view to generating value during the life of the undertaking.

We think it is important to note both the collective, or pooled, nature of the exercise and the purpose of such undertakings when trying to identify an AIF. If there is no collective investment undertaking, which is both a factual and a purposive test, there is not AIF.

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Number of Investors

While we agree that the inclusion of a constitutional restriction to a single investor would prevent an undertaking being an AIF, we disagree strongly that it should be mandatory for any particular provision to be made in instruments of incorporation in order to reach the conclusion that a collective investment undertaking with a single investor is not an AIF. There is no basis in the Level 1 text for the conclusion in paragraph 29. There are likely to be very many arrangements which happen to involve a single investor where there will not be a limit on the number of investors in the instruments of incorporation. For example, the constitutional documents of an ordinary English limited company or English limited partnership will not typically limit the number of shareholders or partners. Nevertheless, in order to be a *collective* investment undertaking, there needs to be some *collective* element, as stated by ESMA in paragraph 28 involving the *pooling* of capital raised from *investors* in the plural (so more than one investor). Otherwise there is no AIF.

If for any policy reason it is considered necessary to allow for the possibility of an undertaking remaining, or being from the outset, an AIF even though in practice it has only one investor at some times we believe a better course would be to say that an AIF may provide expressly in its constitutional documents that it is an AIF subject to the AIFMD (i.e. opt in to the protections of the Directive).

We would also be grateful if ESMA would confirm that, in the case of a limited partnership having only one limited partner and one general partner, where the general partner is part of the management group or the profit share of the general partner is limited (for example to cover the costs of administering the AIF plus audit costs), the limited partnership should not be regarded as raising capital from *a number of investors*. We believe the same position should apply where there are further partners (whether general or limited) that are part of the management group of the general partner. The same conclusion could be reached on the basis of our arguments above, about "raising capital", if the general partner makes only a nominal capital contribution or is not regarded as "external". Nevertheless, we believe that both analyses are valid.

The question of the treatment of a single investor which represents a number of different investors appears to us to be a matter of identifying the nature of the arrangements concerned. We would agree that if a nominee acts for a number of underlying beneficial owners then it is those owners, not the nominee, who should be regarded as the investors, both as a matter of substance and in order to prevent avoidance of the Directive.

However if an AIF, which is itself a collective investment undertaking invests into another undertaking in accordance with its defined investment policy that cannot of itself turn the undertaking in which it invests into an AIF. If it meets the other tests for being an AIF (including but not limited to raising capital from a number of investors) then the investee undertaking will be an AIF. If, however, the investee undertaking is just an investment by the AIF which makes the investment, or a vehicle set up to enable investment in an underlying company or business then the investee undertaking will not be an AIF. This appears to us to be the case whether or not the AIF making the investment can be characterised as a fund of funds or a feeder fund. Neither is sufficient reason to look through it for the purpose of counting the number of investors in the investee undertaking. Feeder funds and funds of funds generally feed into/invest in funds which clearly have other investors and meet all the criteria for an AIF.

We agree with ESMA that, in the case of a true "nominee", which acts on the directions of a beneficiary or third party, it may be appropriate to look through to the beneficial owners for the purposes of assessing whether there is a "number of investors". But it is not appropriate to

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extrapolate from this particular example to the general proposition given in the final sentence of paragraph 29.

Defined investment policy

We welcome ESMA's proposed guidance on "defined investment policy" in paragraph 31.

We have very few comments, which are that:

1. The relationship between the entity and the investor which binds the entity to follow the investment policy need not necessarily be a *contractual* relationship. Just as the AIF may be constituted under the law of contract, trust law, statute or in any other legal form so the duty to follow the investment policy may arise under contract, trust law, statute or in some other circumstances.

2. A number of the characteristics ESMA gives for the defined investment policy appear to us to demonstrate the necessary link between the capital raising and the defined investment policy contained in the Directive definition's reference to the capital being raised with a view to its investment in accordance with the policy. Accordingly the policy needs to be communicated clearly to investors, binding subject to any agreed variation mechanism etc. If this is not done then capital has not been raised with a view to its application in accordance with the policy as well as the policy being insufficiently defined. We suggest this link is made clear.

3. An additional element of a defined investment policy is that it is a policy within which some discretion may be exercised by the AIFM rather that dictating exactly what is to be acquired and done so that there is no portfolio or risk management discretion left.

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

EVCA Response:

Most of our alternative/additional suggestions are given in the answer to question 5 above.

However, the explanation of collective investment should make it clear that managed accounts, i.e. a portfolio of assets managed for or on behalf of one investor, are not caught. The word "investors" is in the plural and it would be useful for the explanation which paragraph 28 envisages to make this clear. It also goes to the heart of what is to be a "collective" undertaking. Where an individual discretionary management mandate is held (which would be subject to MiFID in relation to financial instrument investment) it should not be capable of being regarded as a collective investment. It should be made clear that this also applies when that investor's investments are held by the same nominee or custodian as are investments of other clients and notwithstanding that investments may be made for several clients in parallel by agreement.

Parallel investment, or even co-investment arrangements, do not in our view amount to an AIF unless there is pooling in a collective investment undertaking for the benefit of the investors. The same should apply when a single client's investments are placed in a special purpose vehicle, such as a limited partnership in which that investor is the sole limited partner. It should not be regarded as sufficiently collective to be an AIF (subject to the point made above about a possible "opt in" to the Directive in the constitutional documents even for a single investor fund, provided its constitution does not limit it to a single investor).

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

EVCA Response:

We have given our detailed comments on this in the answer to question 5 above but in brief:

- we consider capital raising from external, unaffiliated/third parties to be an essential element of the AIF definition
- we agree it needs to be an enterprise with commercial reason of generating profits for investors
- we agree there must be a business communication by or on behalf of the entity seeking capital which results in the transfer of cash or assets to the AIF
- we think there should be express linking of the capital raising with the defined investment policy
- we think the capital raising should be by or on behalf of a sponsor which plans (itself or through a group member) to make a profit out of the management of the capital raised from third party/external sources.

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

EVCA Response:

For the reasons set out above, we believe that any capital committed by the AIFM, an affiliate, its owners, partners or other executives, or their family or close associates should be ignored for the purposes of assessing whether there is “capital raising” and/or capital raising “from a number of investors”.

To regard any such investment as external/third party capital, or as separate investors making up a collective number with a single external investor would be contrary to the facts, and to the investor protection goals of the Directive.

Putting it another way co-investment of the manager (or related persons) should not be taken into consideration because to do so would undermine the separation between manager and investor in the definition of AIF in Art 1(a)(i) which envisages a separation between the undertaking, acting through its AIFM which raises capital and the investors from whom it raises capital. The AIF will normally act through its manager. Therefore, to say that the AIF can raise capital from the manager (as a co-investor) would be akin to saying that the AIF can raise capital from itself which is at odds with the definition.

The co-investment merely serves the purpose of aligning interest. It is not an active marketing or capital raising, but a commitment given by the managers and connected persons, as required by

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the investors from whom capital is in fact raised, in order to align interests with those of the investors.

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

EVCA Response:

We generally support ESMA's conclusions in paragraph 33 and in particular that investors in AIF do not individually directly own the underlying assets. If investors who did individually directly own assets decided to have them managed in parallel, or even held by the same nominee but for each of them separately, that would not be sufficient for an AIF. There needs to be a collective investment undertaking involving pooling and the investors interests will be in that undertaking. However the precise nature of those interests can vary widely (and include at least "shares/units/other interests") and not all possibilities are covered in paragraph 33.

In a typical PE fund the investors become a limited partner in a partnership and are entitled to profits and income as limited partners based upon the limited partnership agreement. The limited partnership is not typically unitised and even if limited partner interests are expressed in unitised form (which is very rare) the assets are partnership assets held for the partnership business, rather than partners having individual entitlements to the underlying assets. This is not the same thing as the investors being the beneficial owners (in undivided shares) of assets held on trust for them, which would be the case in a unit trust.

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

EVCA Response:

We agree with the conclusion in paragraph 34. It is a key element of an AIF that management in accordance with the defined investment policy is to be undertaken by someone other than the investors (i.e. by the AIFM or its delegate). Where investors have discretion or control over investment decisions we do not believe the arrangements constitute an AIF. We are not sure what the words "day to day" add to the reference to investors not having discretion or control and suggest they should be omitted. If investors have any discretion or control over investment decisions it would not seem to be an AIF. We note this is in contrast to investor controls or approvals which may be required for conflicts of interest or for stepping outside the basic defined investment policy.

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

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

EVCA Response:

We agree with ESMA that this interpretation is relevant only in the context of the AIFMD and is without prejudice to equivalent definitions in other pieces of EU legislation.

We suggest that the minimum frequency for repurchase or redemption should be 24 months (e.g. in line with the requirement by the German regulator BaFin for the qualification as open-ended fund) although we note that private equity funds would not normally have power to repurchase or redeem interests at the holder's request even at such infrequent intervals.

It is helpful that ESMA has made it entirely clear that an open-ended fund must provide redemption rights so that evergreen and listed funds whose shares are typically transferable are not open-ended when they do not have redemption rights, and nor are fixed life partnerships or companies where investors receive a final return on the winding up of the relevant partnership or company.

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

EVCA Response:

Generally we do not think it should be necessary. We note that although there are specific proportionality provisions for certain Articles proportionality should be applied to all articles. It is a general principle of law and regulation. We also note that ESMA is to consider proportionality in relation to remuneration provisions in the work it has commenced on remuneration guidelines. We trust that in doing so it will bear in mind that the size of the AIF is not the only relevant factor.

There may be some merit in addressing which types of AIF are capable of internal management and which are not, although the situations and structures involved may vary too widely to give certainty. We have addressed this separately below in our comments on the identification and appointment of the AIFM, topics to which no questions were addressed, rather than in answer to this question.

VI. Treatment of UCITS management companies

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

EVCA Response:

A UCITS management company which acts as an AIFM in relation to AIFs will be required to obtain additional authorisation under the AIFM Directive to act as an AIFM only in those circumstances in which a non-UCITS AIFM is required to obtain authorisation as an AIFM. For instance, this means

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that no authorisation under the AIFM Directive will be required in the cases set out in Article 3 of the AIFM Directive (Exemptions). The transitional provisions in Article 61 of the AIFM Directive apply equally to UCITS managers and non-UCITS AIFM.

We agree that it will be possible for UCITS management companies to provide services, including investment management services, to AIFs without being the appointed AIFM and that in that case all of their activities will be covered by UCITS and it will not be necessary to obtain an additional authorisation under the AIFMD.

We agree that UCITS management companies which have dual authorisation as AIFM should be treated in exactly the same way as other AIFM in relation to activities carried on pursuant to the provisions of the AIFM Directive. This treatment should ensure a level playing field between AIFM-only firms and UCITS managers who are also AIFM, in respect of their AIFM activities.

We do not understand the reference in paragraph 51 to taking into account conflicts of interest. Article 14 of the AIFM Directive imposes requirements on all AIFM in relation to conflicts of interest. There are no bespoke additional requirements for UCITS management companies acting as AIFM. To the extent that conflicts arise between the UCITS activities of UCITS managers and their activities as AIFM, these need to be identified and addressed in accordance with Article 14. We suggest that either this reference is removed from the guidance or if included, that ESMA explains in more detail which conflicts it has in mind.

VII. Treatment of MiFID firms and Credit Institutions

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

EVCA Response:

We agree that Article 6(8) of the AIFM Directive expressly recognises that MiFID firms and credit institutions which perform portfolio management services for AIF are not required to obtain authorisation as AIFM. However, we note that:

- The obligation to comply with the requirements set out in Article 20 relating to delegation is imposed on the AIFM. It is the AIFM which is required to ensure that any delegate meets the relevant obligations.

- Credit institutions and investment firms may be appointed to perform activities for AIF under delegation arrangements for the purposes of Article 20, such as portfolio management or risk management. However they may also perform functions for AIF which are outside the scope of that provision. ESMA's policy should recognise that none of the following services involve a delegation under Article 20:

    - acting as a depositary or a sub-delegate as a depositary;

    - another activity which would not otherwise be undertaken by the AIFM (as it falls outside the scope of Annex I), such as the provision of market data;

    - where the terms of an AIFM's appointment is limited to risk management and portfolio management, other activities falling outside of the scope of Annex I paragraph 1.

More generally, there are significant differences across the European Union in whether Member States regard private equity and venture capital portfolio managers and providers of ancillary

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services to be authorised under MiFID. This means that a firm carrying out a particular PE/VC business may require authorisation to perform that business under MiFID in one Member State, but not in another. One result of this is that the practical effect of the implementation of the AIFM Directive on the European Union PE/VC community may differ between member States. In those member States where firms are currently required to be authorised under MiFID and will in future be categorised as AIFM, the limitations in Article 6 may require them to restructure their businesses in a way which may not be necessary in other member States.

We agree that where a MiFID firm is acting as a delegate of an AIFM under Article 20, it is not acting as an AIFM and so the thresholds in Article 3(2) are not relevant.

We do not agree that a firm which is authorised under MiFID "cannot be appointed the AIFM for an AIF". This appears to be possible where the MiFID firm is an AIFM for an AIF in circumstances where the MiFID firm does not require authorisation as an AIFM. For instance, this may be the case where the exemptions in Article 3 apply (so that it requires registration) or the transitional provisions in Article 61 mean that no such authorisation is required at the relevant time.

ESMA should give further consideration to the possibility of dual registration (notwithstanding Art. 6(2) of the AIFM-D) due to the high number of managers which are currently MiFID firms in particular for carrying out reception and transmission of orders and investment advice. Our interpretation is that they can continue to do so under dual registration.

Where Member States authorise external AIFM to perform one or more of the activities in Article 6(4), those AIFM should be entitled to perform those services on a cross-border basis across the European Union, either on a services or branch basis. The UCITS directive contains express passporting provisions for these activities (Articles 16-18). The AIFM Directive does not expressly include such a passport, even though it imposes equivalent requirements on AIFM who perform portfolio management to those imposed in both the UCITS Directive and MiFID/CRD.

In order to ensure equivalent treatment of AIFM and UCITS managers in this regard, it is important that ESMA facilitate an equivalent passport. ESMA might provide guidance that AIFM should be entitled to rely on treaty rights under TFEU and co-ordinate amongst its members accordingly. Alternatively, we note that the AIFM Directive does not include an express statement that an AIFM cannot be dual registered as a MiFID firm (although this appears to be the implication of Article 6(2)).

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Set out below our a number of comments on matters which either were not directly raised in the Discussion Paper or were raised but without questions linked to the relevant sections.

III. Definition of AIFM

ESMA did not pose any questions in relation to this part of its paper. We hope that ESMA will nevertheless consider our comments since we believe the paper raised some very important issues.

We agree generally with ESMA's analysis in paragraphs 4 to 6. More specifically we agree that there is inconsistency, or at least ambiguity, in the relationship between Article 6(5)d and Article 4(1)(w) and welcome ESMA's attempt to clarify the matter. Our understanding of paragraph 6 is not that any entity which performs either risk management or portfolio management for an AIF must seek authorisation as an AIFM, since that could jeopardise the requirement that each AIF should only have one AIFM. Instead it is our understanding that if an AIF uses one entity for portfolio management and another for risk management it is possible to choose which of the two entities becomes the AIFM, with the one chosen being obliged to take overall responsibility for both functions, while delegating one to the other entity.

We also agree with the delegation description in paragraph 7. We note that while delegation does not affect an AIFM's liability vis-à-vis investors, that does not preclude the AIFM from seeking indemnification from the delegate, which would benefit investors by furthering the financial health of the AIFM where a delegate has caused damage.

We assume that to the extent the AIFM takes investment decisions it would not be considered a letter box and no further substance is required.

With respect to the statement that a person performing either the portfolio management function or the risk management function is not required to be authorised if it performs those functions in accordance with a delegation arrangement "with an AIFM in accordance with Article 20 of the AIFMD" it may be helpful to clarify that delegates are not responsible for monitoring the compliance of the AIFM itself with Article 20 of AIFMD (which is likely to be impossible for it to do from its position as a delegate).

Although it will never be the responsibility of the delegate to monitor the quality of the supervision to which it is subject or to ensure that the AIFM is acting in compliance with Article 20 of the AIFMD, a delegate that has taken reasonable measures to confirm that the AIFM delegating to it is not a letter-box entity shall not be considered to be acting as an AIFM if it is later determined that the AIFM that delegated to it was a letter-box entity or was otherwise not acting in compliance with Article 20 of the AIFMD.

Furthermore, we disagree strongly with the conclusion in paragraph 8 that an AIFM may not delegate both portfolio management and risk management in whole at the same time. There is no basis for this conclusion in the Level 1 text. We believe that an AIFM is entitled to delegate the whole of both functions at the same time provided that it: (1) retains responsibility to the AIF or to investors for the whole of both functions; (2) retains the expertise and resources to supervise the delegated functions effectively and to manage the risks associated with the delegation; and (3) retains the power (under or consistent with the constitutional documents of the AIF) to terminate the delegation and reserve the performance of either or both functions to itself, or to appoint a different delegate.

Where Articles 4(1)(w) refers to "performing" the functions, and Article 6(5)(d) refers to "providing" the functions, we believe that this should be interpreted to mean that the AIFM must take responsibility for the performance or provision of those functions to the AIF (e.g. if the

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AIF has legal personality) or to investors. An overly narrow interpretation of those words would preclude any delegation of the sort contemplated by paragraphs 4 to 6 of the Discussion Paper and Article 20.

The risk that an AIFM might delegate to too great an extent is expressly catered for in Article 20(3) and ESMA's advice to the European Commission on delegated acts under Article 20(7)(b) i.e. in the concept of a "letter-box entity". ESMA's advice is set out in Box 74 of ESMA's Final Report. We agree with ESMA's advice in Box 74. We believe that ESMA's advice in Box 74 may be inconsistent with its conclusion in paragraph 8 of the Discussion Paper. Even if that is wrong, it is unnecessary to reach the conclusion in paragraph 8. If the AIFM retains control and general oversight including responsibility, expertise, resources and powers as contemplated in Box 74, there is no regulatory risk in the delegation of the whole of both portfolio management and risk management functions.

We also disagree strongly with ESMA's conclusion in paragraph 10 that, where the AIFM does not itself perform the functions in paragraph 2 of Annex 1 of the AIFMD, those functions should be deemed to have been delegated by the AIFM to a third party. There is no basis for this conclusion in the Level 1 text. Annex 1 expressly provides that the functions in paragraph 2 are those that the AIFM "may additionally perform". The AIFM is not required under Article 6, Article 20 or otherwise either to perform them, or to have responsibility for them itself. Recital 11 expressly contemplates that there will be aspects of the operation of an AIF for which, in some fund structures, the AIFM will not be responsible. We submit that many of the functions in paragraph 2 to Annex 1 are functions for which the AIFM may not be responsible.

For example, in relation to a corporate AIF whose shares are listed and admitted to trading on a regulated market, the board of directors of the AIF will be responsible for functions such as dealing with shareholders, the issue and redemption of shares and the maintenance of the shareholder register. Community company law and/or the domestic company law of the Member State and/or the applicable listing rules may make the board responsible for those functions, and it is desirable for reasons of corporate governance and the discharge of directors' fiduciary duties that they should be so responsible.

Similarly, where the AIF takes the form of a limited partnership, and the appointed AIFM is an external manager, the general partner may wish to perform certain of the functions listed in paragraph 2 of Annex 1. The general partner may be made responsible under applicable domestic law for the performance of some of those functions. Tax authorities may also require the general partner to demonstrate economic substance: where this is required, there is no regulatory justification for preventing the general partner being responsible for the functions in paragraph 2 of Annex 1.

From an investor protection perspective, if the third party (the board of directors or the general partner in our examples) performs any of those functions in a way which is inconsistent with the mandatory requirements of the AIFMD, then recital 11 provides a mechanism for addressing this, including notification to the competent authority and resignation of the AIFM. It is not necessary to reach the conclusion in paragraph 10 of the Discussion Paper.

V. Appointment of AIFM

We agree with paragraph 43 that each AIF must have only one AIFM with responsibility for compliance with the Directive and with paragraph 44 that depending on the structure of the AIF there may be more than one legal entity which could be appointed AIFM. It may also be for example that one entity assumes portfolio management and another risk management functions. In

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such case the AIF shall be free which one to appoint as AIFM and the other entity is then a delegate (see above).

Article 5 explicitly foresees that AIF which due to their legal form can be internally managed should be free to appoint an external manager or to act itself as internally managed AIF. This is very clear for SICAV structures and other investment companies which have a legal personality and can act themselves without needing an external manager to represent the AIF or can appoint an external manager.

Where the AIF does not have legal personality the definition of an AIFM, which requires a legal person whose regular business is managing one or more AIF, would seem to mean that the AIF could not be internally managed. However this is not entirely clear.

The same question arises with respect to limited partnership structures: should the general partner representing the partnerships be regarded as an external AIFM or could it be seen as the corporate organ carrying on the internal management of an internally managed AIF.

Some limited partnerships have legal personality, and others do not. Their methods of management do not in practice vary depending on whether they have legal personality. The one certainty is that the limited partners, i.e. the investors, will not manage the partnership since if they did so it would jeopardise their limited liability. Essentially the possibilities are:

1. Management by a sub-group of partners acting as an investment committee;

2. Management by a general partner which carries on or delegates portfolio and/or risk management;

3. Appointment of an external AIFM, with the general partner either being excluded from management or having limited retained powers.

The first of these is very rare and, but for the question whether a partnership without legal personality can be internally managed would seem to amount to internal management.

The last of them is clearly the appointment of an external AIFM.

Arguably the second situation is more complex. It appears to us that management by a Managing General Partner in this way could be regarded as internal management because the MGP is just acting as a partner as permitted under the partnership agreement, but that, unless there is express agreement by the investors in the fund documentation that it should be so regarded, there are good policy reasons not to do so. Internal management of an AIF generally has the consequence that claims made by an investor are borne by the AIF, and thus, indirectly, by all investors. Investor protection should generally be of the limited partners against the General Partner in just the same way as investors are protected when there is an external manager. It is logical in investor protection terms to treat the GP (where it has sufficient substance and is not a letterbox) as an external AIFM. This would be in line with the investor understanding worldwide, which regards terms GP and Manager as similar.

Matters not covered in the Discussion Paper

We note that ESMA does not address explicitly in the Discussion Paper one important question. This is whether and in what circumstances a set of arrangements between several legal or natural

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persons should be considered to be a single AIF or multiple AIF. We would be grateful if ESMA could consider this point in its final technical standards.

We acknowledge that an AIF could take any legal form, and that it need not be a body corporate, nor have separate legal personality. However, it is an essential feature of an AIF that it must be an "undertaking". This is part of the definition of "collective investment undertaking". The term "undertaking" is not defined in any Community act. However, in Case C-41/90, Höfner and Elser v. Macrotron GmbH: [1991] E.C.R. I-1979 it was held in the context of Community competition law that, "...the concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed...". The term therefore encompasses a company, partnership or limited partnership. It is likely that for the purposes of the AIFMD the term will stretch to encompass certain other pooled investment vehicles, such as FCPs and unit trusts. However there should still be some form of pooled collective investment vehicle, and not, for instance mere parallel investment arrangements and ordinary corporate and joint venture arrangements should not be inadvertently caught by too wide an interpretation, even if one of the participants is a fund. Where there is an identifiable undertaking, the AIF will be that undertaking and not any wider set of arrangements.

Example 1

Typically in a particular private equity fund, there will be several "parallel" limited partnerships. There might be one or more English LPs and a German KG. The different vehicles exist in order to accommodate different tax treatments applied to particular types of vehicle by global tax authorities which might affect particular classes of investor. The parallel vehicles may have a common general partner and will almost certainly have a common AIFM. In our view, each undertaking – i.e. each limited partnership and each KG – is properly regarded as a separate and distinct AIF. They should not be regarded as making up a single AIF. Indeed if they were regarded as doing so it could be impossible to apply depositary provisions requiring the depositary to be located in the home jurisdiction of the AIF.

Example 2

A private equity AIF structured as a limited partnership may have amongst its limited partners another limited partnership. The purpose of this other limited partnership is to facilitate participation by special investor groups (addressing their regularly concerns) as well as executives of the AIFM in carried interest and/or co-investment arrangements. The limited partnerships are likely to have a common AIFM. If the second limited partnership exhibits the features of an AIF (e.g. if it raises capital from a number of investors with a view to investment in accordance with a defined investment policy – see below), then in our view there will be two separate AIF, one a feeder fund into the other. If it does not, there will be one AIF, which is the main fund limited partnership.

Submission

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About the PAE

The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.

About EVCA

The European Private Equity and Venture Capital Association is the voice of European private equity and venture capital, representing more than 1,300 members. In addition to promoting the industry among key stakeholders, such as institutional investors, entrepreneurs and employee representatives, EVCA develops professional standards, research reports and holds professional training and networking events.