MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

March 23, 2012

Via *FSA Website*

Investment Funds Team
Conduct Policy Division
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Re: FSA Discussion Paper "Implementation of the Alternative Investment Fund Managers Directive" (January 2012)

Dear Sir or Madam:

Managed Funds Association ("**MFA**")[1] welcomes the opportunity to provide responses to the Financial Services Authority's ("**FSA**") Discussion Paper; MFA's responses are set out in the Annex to this letter.

Throughout the drafting process on the Alternative Investment Fund Managers Directive (the "**AIFMD**"), MFA engaged with EU policy makers in what we hope was a thoughtful, constructive manner on a number of important issues, most notably in relation to the effect of the AIFMD on non-EU AIFMs. We now welcome the opportunity to work with the FSA and other Member State competent authorities in connection with the implementation of the AIFMD.

MFA would like to take the opportunity provided by the Discussion Paper to comment on a number of matters that MFA believes will assist the FSA in preparing its consultation papers on the AIFMD. Though there are many issues covered in this letter, MFA would like to highlight the following key points:

- Scope (Who is an AIFM?) – so long as the non-EU AIFM is not a letter-box entity, an EU delegate of that non-EU AIFM would be a MiFID firm rather than an AIFMD firm.

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $2.0 trillion invested in absolute return strategies. MFA is headquartered in Washington D.C., with an office in New York.

- Operating Requirements:
    - Standards of protection for retail customers should not apply equally to professional investors; the AIFMD has been designed specifically with professional investors in mind.
    - The implementation of the remuneration provisions under the AIFMD should be consistent with that under the existing CRD3 framework; a MiFID firm subject today to the CRD3 standard and which subsequently becomes authorised as an AIFM should not be faced with more stringent remuneration requirements under the AIFMD.
    - "Functional and hierarchal independence" of risk management should not preclude an AIFM having a risk management function that involves input (substantial or otherwise) from portfolio management personnel.
- Transparency – because a number of regulators around the world request information from fund managers, we encourage the FSA to consider an internationally coordinated approach to reporting. It is also critical that proprietary information of AIFMs/AIFs remain confidential.
- Marketing – where an AIFM is approached by a potential investor under a reverse solicitation process, any marketing by the AIFM of further units in the relevant AIF should be covered by the initial reverse solicitation.

We would be very happy to discuss our comments or any of the issues raised in the Discussion Paper with the FSA. If the FSA has any comments or questions, please do not hesitate to contact Benjamin Allensworth or the undersigned at +1 (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell

Executive Vice President &
Managing Director, General Counsel

ANNEX

MFA responses to FSA Discussion Paper:

"Implementation of the Alternative Investment Fund Managers Directive"

CHAPTER 3 – SCOPE

Who is an AIFM?

MFA notes that FSA has not asked specific questions in this section of the Discussion Paper. However, MFA would like to take this opportunity to provide its thoughts on the issues issue. We have also communicated our thoughts below to ESMA in our comments on Section III (Definition of AIFM) of ESMA's Discussion Paper of 23 February 2012 ("Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM").

As a general matter MFA agrees with ESMA's proposal in its Discussion Paper that no authorisation as an AIFM under the AIFMD is required when the performance of either the portfolio management or the risk management function is done under a delegation arrangement with an AIFM in accordance with Article 20 of the AIFMD.

However, MFA notes that the "AIFM" concept relates both to EU as well as non-EU AIFMs. In the case of a non-EU AIFM which is not itself authorised under the AIFMD, the delegation arrangements would not specifically be in accordance with Article 20 of the AIFMD. This would be the case where, for example, a US AIFM appoints an EU-based entity – typically authorised as a MiFID firm – as its delegate for the purpose of carrying on portfolio management activities in relation to an AIF managed by that US AIFM. The EU delegate does not typically have any contractual relationship with the AIF; its sole client is the US AIFM. In such circumstances, in accordance with ESMA's proposal, the EU delegate should be authorised as a MiFID firm rather than an AIFMD firm. MFA agrees with ESMA that the key issue is that the delegation by the non-EU AIFM should not be to "to such an extent that the AIFM becomes, in essence, a letter-box entity and can no longer be considered to be the manager of the AIF."

MFA also notes that Article 5(1) of the AIFMD requires that an AIF have a single AIFM. Assuming the actual AIFM (regardless of domicile) is not a letter-box entity, that AIFM would be the "single AIFM" for the relevant AIF. It does not matter that the AIFM may not be in the EU and may thus not be delegating in accordance with Article 20 of the AIFMD. So long as the non-EU AIFM is not a letter-box entity, an EU delegate of that non-EU AIFM would be a MiFID firm rather than an AIFMD firm.

Accordingly, MFA has urged ESMA to make clear that its approach on delegates of AIFMs includes situations where the AIFM is a non-EU AIFM.

Joint ventures

Question 1: What other criteria could be used to distinguish a JV from an AIF and, in particular, a JV where not all participants are involved in its day-to-day management?

No comment.

Family investment vehicles

Question 2: How should we look to characterise the 'family relationship' between investors?

No comment.

Question 3: Are there other features of a family investment vehicle that might distinguish it from an AIF?

No comment.

Small AIFMs

Question 4: (a) Which aspects of the Directive should we consider applying to small UK AIFMs? (b) In particular, which aspects of the Directive should we consider applying given that a distinction may be drawn between types of AIF or AIFM?

No comment.

CHAPTER 4 – OPERATING REQUIREMENTS ON AIFMS

General principles – Fair treatment

Question 5: What factors should be considered when assessing the fair treatment of consumers, especially where some investors in a fund have received preferential treatment?

MFA is of the view that the existing FSA rules on preferential treatment, including as to side letters, is appropriate for the protection of the kinds of investors contemplated by the AIFMD (i.e. professional investors), and there is no need to adjust that regulatory standard upon the implementation of the AIFMD in the UK.

Question 6: Do you agree that fair treatment of retail consumers should equally apply to professional investors?

MFA is of the view that it would not be appropriate to apply a retail standard of protection where the investors are professional investors (professional investors being contemplated in the AIFMD context).

While we understand that "consumers" in Principle 6 of the FSA Principles for Business could, as a result of the FCA Approach Document, be broad enough to include professional investors, we note that the FCA Approach Document also states: "the FCA will adopt a differentiated approach to protecting different categories of consumer."[2] That is, even if professional investors were afforded the protection contemplated by Principle 6, they would not be afforded the same level of protection as retail customers.

Although the AIFMD contemplates that Member State regulators may allow for the marketing of AIFs to retail investors in their respective jurisdictions, the AIFMD framework has been designed specifically with professional investors in mind, and it would be inappropriate to introduce retail consumer protection concepts into the AIFMD framework. MFA is of the view that, in relying upon existing concepts in the UCITS Directive and MiFID, ESMA and each Member State regulator (including the FSA) should bear in mind that, as AIFMs deal with professional investors rather than retail investors, the provisions under MiFID and the UCITS framework which are aimed at protecting a wide range of investors (including retail investors) may not always be appropriate and should be adjusted accordingly. Amongst other things, AIFMs do not have the benefit under the AIFMD of an EU passport for marketing to retail investors, and so the standards applied to AIFMs should not simply reflect those in UCITS.

[2] Paragraph 3.8 of the FCA Approach Document.

General principles – Conflicts of interest

Question 7: What organisational arrangements might raise particular issues for UK AIFMs? Do these requirements pose particular difficulties for private equity firms in the light of their distinct business model?

MFA believes that the existing approach taken under MiFID to conflicts of interest, and which apply to FSA regulated firms already, is appropriate and no specific additional requirements need to be imposed on account of the AIFMD. In this regard MFA agrees with the FSA that the conflicts of interest provisions of SYSC 10 of the FSA Handbook are broadly aligned with the AIFMD provisions and ESMA's advice.

As MFA members primarily are hedge fund managers rather than private equity firms, MFA does not propose to respond to the second part of Question 7.

General principles - Remuneration

Question 8: What are the major challenges in the development of remuneration guidelines appropriate to the structure of AIFMs?

Question 9: What options could be considered for implementing the remuneration requirements of the Directive that would achieve fair and appropriate alignment with the existing Remuneration Code?

Question 10: What are the practical issues for potential AIFMs in establishing a remuneration committee?

We address Questions 8 to 10 together in this response.

MFA strongly supports an approach under which MiFID portfolio managers, who become AIFMs under the AIFMD, are not subject to enhanced remuneration requirements. That is, if a MiFID portfolio manager is currently a "tier 4" firm under the existing FSA Remuneration Code, that MiFID manager should not be subject to enhanced remuneration requirements should that MiFID manager apply to become an AIFM under the AIFMD. To that end MFA supports the FSA's view that its "transposition of the Directive will need to take full account of the requirements of CRD3." Given that the remuneration provisions of the AIFMD are based on those in CRD3, the impact on firms should be the same, regardless of whether they are subject to MiFID (and thus CRD3) or the AIFMD. It would be inequitable for a firm to be subject to a higher remuneration requirement just because it moved from being a MiFID firm to be an AIFMD firm.

Organisational requirements

Question 11: What criteria should be used to determine whether it is disproportionate to require an AIFM to have a separate compliance function? What criteria should be used to determine whether it is disproportionate for an AIFM to establish an audit function?

MFA believes that the FSA should be guided by the proportionality principle set out in Article 6(1) of the MiFID Implementing Directive. Compliance arrangements should be appropriate in view of the size of the firm, complexity of its operations and its organizational structure. As a general matter, the effectiveness of the compliance function cannot necessarily be ensured by its independence from the influence of senior management or other business units. Conversely, the independence of the compliance function cannot be guaranteed by the compliance officer holding a particular position in the organizational structure (i.e. a separate compliance function). A better approach might be to encourage collaboration of the compliance officer with senior management and business units. This collaboration would not necessarily undermine the independence of the compliance officer, provided that the compliance officer has sufficient authority and credibility to access and challenge senior management if required.

More important than independence is a strong culture of compliance grounded in the commitment and active involvement of the senior leaders of the firm. The role of the compliance function should be institutionally important and its success is more likely to be achieved where senior management strongly sponsors this function. A collaborative approach is more likely to lead to effective and sound decision-making by senior management who are ultimately accountable for the firm's failures.

MFA also notes that in smaller firms, the compliance function is often carried out by a member of senior management (and/or member of the governing body of the firm). In many cases, this individual may also be responsible for the provision of investment services. As a senior manager of the firm, such individual will have sufficient authority within the firm to carry out his or her compliance function effectively, provided that such authority is combined with sufficient knowledge of the regulatory requirements and appreciation of regulatory risks. On balance, this arrangement could result in a greater degree of effectiveness of the compliance function than if the compliance function were, for example, carried out by a more junior member of staff who was formally independent of the business function. In this respect, MFA encourages the FSA to clarify that AFIMs may decide that, in some cases, it would be more appropriate in view of the AIFM's organizational requirements that the compliance function is combined with a senior management or a business role.[3]

In relation to the audit function, to the extent an AIFM is required to establish an internal audit function, MFA agrees that the compliance function should not be combined with the internal audit function. However, as a matter of general principle, an AIFM should have the

[3] MFA notes that, under the U.S. Investment Advisers Act of 1940, for example, registered investment advisers must have a chief compliance officer who must be senior enough to effect decisions and to compel others to adhere to the adviser's compliance program.

discretion to decide which combinations would be appropriate in view of its business and organizational structure

Question 12: As organisational requirements are also covered by other Directives relevant to fund management, such as MiFID and the UCITS Directive, will any potential overlap with these Directives create any problems?

No comment.

<u>Risk management – 'Functional and hierarchical' separation or safeguards</u>

Question 13: In what circumstances would you be unable to meet the requirement to have functional and hierarchical separation of your risk management function and would need to rely on having appropriate safeguards?

Although MFA recognises that the AIFMD requires the functional and hierarchal independence of the risk management function from the operating units (including portfolio management) of the AIFM, MFA believes that portfolio management neither can nor should be entirely separated from risk management. Appropriate management of market risk, portfolio risk, liquidity risk, etc. requires the active involvement of portfolio management personnel. Portfolio managers have a significant and integrated role in monitoring and managing the risk. Moreover, portfolio management requires the use of appropriate risk analytics. We believe there should be a balance that allows for appropriate participation of portfolio management personnel.

MFA believes that "functional and hierarchal independence" does not preclude an AIFM having a risk management function that involves input (substantial or otherwise) from portfolio management personnel. For some small or start up AIFMs, it may not be possible to comply with the mandatory requirement to separate risk management from portfolio management without adding staff, which will discourage new entrants to the market, thereby reducing overall employment opportunities in the industry and reducing choice for investors. Portfolio managers are naturally incentivised to identify and manage risk well – if they do not, investors will leave the AIF and the portfolio manager's reputation would be damaged. Moreover, portfolio managers frequently invest their own money in the AIFs they manage aligning their interests with the interests of investors when it comes to managing risk.

Separately, the compliance function in a firm is often combined with the risk management function. MFA believes that this combination can be beneficial, particularly as such an arrangement is likely to ensure that legal and regulatory risks are taken into account in the overall assessment of the investment firm's risk profile and the adequacy of measures to manage and mitigate the risks to the business. As noted above in our response to Question 11, the compliance function is also often combined with the legal unit.

Risk management – Systems and governance arrangements

Question 14: For what reasons might the use of a qualitative, not a quantitative, risk limit, be in the interests of AIF investors?

While the AIFMD risk management requirements are broadly similar to those in the UCITS Directive, given that UCITS investors are retail investors while AIF investors are generally institutional investors, MFA is of the view that the risk limit proposals for AIFMs should be less prescriptive than those for UCITS.

As a general matter, MFA considers market risk to be the main focus of an AIFM's risk policy and would favour a less prescriptive and more flexible principles-based approach to identifying other types of risk that may need to be included in an assessment of the risk limits. In particular, it is not clear what limits on operational risk can be assessed in an AIFM, particularly for small AIFMs. AIFMs should thus generally be given the flexibility to consider risks that are of particular relevance, rather than adopt a "tick the box" approach.

Risk management – Leverage and collateral

Question 15: What constitutes a 'material change' to the maximum level of leverage set for an AIF may vary according to changes in the market. What factors should we take into account in determining what constitutes a material change?

MFA would like to make the general comment that the "material change" in leverage will very much depend on the particular strategy of the AIF (an AIF pursuing a long/short equity strategy may have a different leverage profile from one pursuing a fixed-income arbitrage strategy); accordingly, the factors taken into account will need to be different for different AIFs.

It is also important to note that Article 23(5) of the AIFMD refers to disclosing "any changes to the maximum level of leverage" rather than continual disclosure of actual changes in leverage. An AIFM should be free to exercise its view of leverage for the relevant AIF, so long as it stays within the maximum level of leverage set for the AIF. For example, if the maximum level of leverage for an AIF is 5 times NAV, the AIFM should be free to operate at a level of 3 times NAV, without that being considered to be a change in the maximum level of leverage for which new disclosure is required.

By the same token, the AIFM may have internal leverage limits which it sets for day-to-day operational purposes, which are below that of the specified maximum level of leverage. It should be made clear that such internal limits, which can be regularly adjusted, are not the subject of the disclosure obligation under Article 23(5).

Question 16: A material change to the maximum leverage limit set by an AIFM must be disclosed to investors and to us. Operationally, what will be the best way to report this to us?

No comment.

Delegation

Question 17: What are the particular challenges for your firm as a result of the delegation requirements? How will this affect existing operational structures?

MFA's principal concern in respect of the Article 20 delegation requirements is that there may be a need, in particular in certain emerging market economies, to delegate certain functions to managers who are not authorized by a local regulator, because an exemption might be available. In this regard it is unfortunate that Article 20 does not acknowledge the possibility that a delegate in a third country may have an exemption from the relevant authorization requirement in that jurisdiction; the only requirement should be that an authorization regime exists in that third country.

Separately, MFA wishes to express its support for ESMA's decision in its Final Advice on the AIFMD not to require that delegation to third country managers can only occur where the third country in question has an "equivalent" regime for authorization of managers (as had initially been proposed by ESMA in its consultation paper on that advice).

Capital requirements and professional indemnity insurance

Question 18: Do you have any comments on our analysis as to how we expect the capital and PII requirements to apply to the different types of firm acting as managers of AIFs?

No comment.

Capital requirements and professional indemnity insurance – Use of IPRU (INV) for the new rules

Question 19: Do you agree that it would be appropriate to set out the requirements for UCITS firms and UCITS AIFM firms in IPRU (INV)?

No comment

Capital requirements and professional indemnity insurance – Use of indemnities

Question 20: Do you expect to want to use a guarantee to meet part of the additional own funds requirement?

No comment.

Capital requirements and professional indemnity insurance – Coverage of risks arising from professional negligence

Question 21: Do you have any comments on how AIFMs might comply with any PII requirements adopted in Commission implementing measures based on the ESMA advice?

No comment.

Question 22: To what extent do you expect to use PII as part of the required financial resources to cover professional negligence risks?

No comment.

Capital requirements and professional indemnity insurance – Requirements for internally managed AIFs

Question 23: Do you have any comments on the most appropriate approach to determine the prudential requirements for internally managed AIFs?

No comment.

Capital requirements and professional indemnity insurance – Cross-reference to the CAD

Question 24: Do you have views on the intended meaning of CAD-defined terms and our approach to incorporating them in the rules for AIFMs?

No comment.

CHAPTER 5 – MANAGEMENT REQUIREMENTS ON AIFMS

Valuation – External valuer

Question 25: What are the most significant considerations that we should take into account when assessing the need to require AIFMs to have their valuation procedures and/or valuations verified by an external valuer or auditor?

No comment.

Question 26: What professional guarantees by an external valuer would be sufficient to show that it can meet the requirements of the Directive?

No comment.

Valuation – Calculation of Net Asset Value

Question 27: How should the NAV calculation requirement apply to an AIF that does not use the 'share/unit' concept?

Our observations in this response are restricted to hedge fund structures in which the AIF takes the form of a limited partnership.

In calculating the net asset value per share/unit of an AIF (established with shares/units), an AIF's valuation agent will value the assets in the portfolio as at a certain period of time. The total value of the assets in the portfolio is then reduced by the AIF's liabilities in order to determine the AIF's net assets. The net assets figure is then divided by the number of units/shares that are issued and outstanding in order to come up with the net asset value per share/unit.

This methodology is similar in a limited partnership to the above process however the process changes at the point at which the AIF's net assets are calculated. In a limited partnership, the capital account allocation provisions contained in the limited partnership agreement will determine how the Fund's net assets are then allocated to each partners' capital account. In most hedge funds, this allocation mechanism is based on an equitable allocation generally based on the size of the investor's capital contribution/commitment. Thus, in a hedge fund context, one achieves a similar result in a partnership to determining a corporate AIF's NAV per share taking the calculation one step further and multiplying the NAV per share by the number of shares owned by the particular investor. However, equitable accounting which may be applied where there are different classes of shares/units may not be relevant in a fund that does not use shares/units.

Liquidity management – General principles

Question 28: Are there any particular challenges for your firm as a result of the liquidity requirements?

MFA considers that the high-level approach reflected in ESMA's final advice for liquidity management is broadly appropriate. AIFMs often manage the liquidity of the investment portfolios of their AIFs over a period of time, usually several years, and seek to manage the general liquidity profile of the portfolios in a manner that is consistent with the obligations of the respective AIF over time, though this is not necessarily the same as matching the liquidity of the AIF to its obligations. An overly rigid requirement to match an AIF's redemption terms to the liquidity of its investment portfolio would unduly restrict the investment options for AIFMs. For example, an AIFM may be required to hold excess levels of cash and cash equivalents in the portfolio to hedge against possible redemptions and the possibility that unexpected market events may change the liquidity profile of the AIF's investments, leaving the portfolio less than fully invested which may adversely affect the risk/return profile that investors expect from the AIF.

Separately, MFA notes that as professional investors, AIF investors are in a position to determine the risk in investing in AIFs that may use liquidity management arrangements (such as gates and side pockets) and are generally familiar with the operation of such arrangements. Thus, provided there is clear disclosure of the use of arrangements to investors in the AIF's documentation, AIFMs should be able to use these methods as part of their normal liquidity management policies.

Leverage

Question 29: What criteria should we take into account when considering whether arrangements of capital commitments might be temporary in nature?

MFA Response:

No comment.

Leverage – Calculating leverage

Question 30: In what instances do you consider that neither the Gross nor Commitment methods of leverage calculation would provide a reasonable or approximate reflection of leverage within an AIF?

MFA Response:

ESMA acknowledged in its final advice that the general view of industry is that the Gross method is not in any way an accurate measure of leverage. MFA had commented to ESMA that net assets under management, not gross assets, best reflects investor capital that is at risk. Net

assets, as calculated on an AIF's balance sheet and audited annually, are easily verifiable. Gross assets, including when calculated using the Gross Method set out in Box 95 of ESMA's final advice, can lead to confusion and significant uncertainty for market participants given the different ways the elements of Box 95 could be calculated.

MFA notes that ESMA has rejected the use of the Value at Risk ("VaR") methodology in its final advice and preferred instead to use the Commitment Method (in addition to the Gross Method). Given the very wide range of types of AIFs and strategies that may be employed, MFA believes that in order to provide flexibility and to identify the most appropriate measure of exposure for an AIF, AIFMs should be permitted to utilise a variety of methods, including VaR. As the European Central Bank noted in its paper *Hedge Funds and their Implications for Financial Stability*:

> "Accounting-based balance sheet measures of leverage [such as gross/net balance sheet leverage] fail to reflect the risk of the assets. Risk-based measures [such as VaR] alleviate this shortcoming by relating market risk to the capacity to absorb it."[4]

MFA believes that, in the event that the Commission accepts ESMA's advice and considers that a Gross Method exposure calculation be employed, any positions implemented to mitigate foreign exchange or interest rate risk from investments in the AIF's portfolio should not be included in the calculation of gross exposure. For example, if a USD denominated AIF holds 100mm of EUR denominated bonds and has also sold 100mm EUR forward to receive USD, this transaction should only have an exposure of the 100mm EUR converted to USD at the relevant foreign exchange rate. Similarly, if an AIF holds a portfolio of corporate bonds and has sold US Treasuries as an interest rate hedge, including both the corporate bonds and Treasuries will overstate the AIF's gross exposure. In this example, the Treasuries protect the AIF from adverse movements in interest rates which will impair the valuation of the corporate bonds, and as a result reduce overall portfolio risk.

In respect of the Commitment Method, MFA notes that ESMA's final advice imposes a very narrow definition of hedging arrangements, in line with the CESR Guidelines on Risk Management and the Calculation of Global Exposure and Counterparty Risk for UCITS (the "**CESR Guidelines**"). MFA believes that the CESR Guidelines, which were drawn up for the UCITS framework, do not reflect an approach that should be used for AIFMs. Unlike UCITS, which may require a more conservative approach due to the fact that UCITS are retail products, investors in AIFs are professional/institutional and would expect "hedging" to include dynamic hedging strategies that are commonly used outside of the UCITS framework. One example ESMA gives of a situation which does not comply with its suggested hedging criteria is a where a person hedges a long equity position of an issuer with a CDS on bonds of the same issuer, on the basis that the hedging relates to two different asset classes. This sort of hedging is precisely the kind of dynamic hedging engaged in financial markets on a daily basis, and ought to be recognised for AIFs/AIFMs under the Commitment Method. Otherwise it is difficult to contemplate how the Commitment Method could reasonably be of use.

[4] *Hedge Funds and their Implications for Financial Stability*, ECB, 2005, at page 30.

Finally, MFA believes that the Advanced Method should not be seen to be a unique method by which specific notification and other requirements need to be imposed in order for it to be used. The Advanced Method should simply be one of the options available to AIFMs, so that AIFMs can choose the method most appropriate for their AIFs (Gross/Commitment, VaR, Advanced). MFA understands that ESMA will be consulting on the Advanced Method and we will provide responses to that consultation when it is published.

Investment in securitisation positions

Question 31: What aspects of the proposed requirements for investment in securitisation positions present the most significant challenges and/or create the most significant degree of uncertainty for AIFMs, including in relation to the interaction with the existing requirements applicable to credit institutions and insurance undertakings?

As a general comment MFA is of the view that the Article 17 AIFMD requirements should be aligned properly with those of Article 122a of the Capital Requirements Directive.

Question 32: Do you anticipate any particular issues or challenges arising from the grandfathering provisions for investment in securitisation positions?

No comment.

CHAPTER 6 – TRANSPARENCY

Disclosure to investors – Retail investors

Question 33: Do you agree that our existing disclosure requirements for NURS should be maintained?

MFA members do not generally target retail investors and so MFA does not propose to comment on NURS requirements.

Disclosure to investors – Disclosure relating to AIFM use of leverage

Question 34: Subject to the minimum disclosure requirements in article 23, do you consider that our existing QIS disclosure requirements should be maintained?

No comment.

Annual reporting – Disclosure of remuneration

Question 35: What are the implications, if any, of the remuneration disclosure requirements for those firms already subject to the provisions of the FSA's Remuneration Code?

No comment.

Question 36: What are the implications for firms currently outside the Remuneration Code, e.g. real estate funds and private equity firms?

No comment.

Reporting obligations to the FSA

Question 37: Reporting by third country AIFMs marketing AIFs in the UK will need to be captured. There is no current process for this. What do you believe would be a practical solution for this?

There are a variety of ways in which such reporting could be captured from a practical perspective (e.g. using the same system that the FSA will presumably be establishing in order for net short positions in shares and sovereign debt to be notified to the FSA pursuant to the EU Short Selling Regulation), but MFA wishes to focus on two issues which are particularly important from the perspective of our members.

Coordinated reporting

Because a number of regulators around the world request information from fund managers, we encourage the FSA to consider an internationally coordinated approach to such reports. A coordinated approach would likely be more valuable to regulators, as coordinated reports are more likely to produce data that can be compared across jurisdictions and would eliminate double counting of managers of funds, which will be critical to assessing the state of the financial system in a globally integrated marketplace. A coordinated approach would also be important to global fund managers, which are required to expend significant resources responding to requests for data. We also encourage the FSA to consider the extent to which requesting information from the prime brokers, exchanges, swap data warehouses and other market participants and utilities used by AIFMs may be a more effective or efficient way to gather and analyze information.

Many MFA members, as U.S. AIFMs, are or will be registered investment advisers under the Dodd-Frank Act and will be required to prepare extensive reports to the U.S. Securities and Exchange Commission ("**SEC**"), for example under Form PF. Much of the information that a U.S. AIFM would be compiling and organising under Form PF is equally applicable under the AIFMD reporting requirements. It would be extremely time-consuming and expensive for such U.S. AIFMs to have to compile such similar information in a different format just so as to fit within the AIFMD requirements. MFA therefore encourages the FSA to adopt an approach under which a U.S. AIFM which is filing the relevant reports to the SEC need only to file with the FSA the Form PF plus a supplement to cover matters not otherwise required under Form PF. Where there is any reason to investigate more closely the affairs of a particular U.S. AIFM, the FSA could require that U.S. AIFM to file the complete report in the format required by the FSA of UK-based AIFMs. MFA believes that the suggested approach is consistent with the AIFMD, in that the AIFMD places the obligation on AIFMs to disclose the relevant information; the AIFMD does not place an obligation on Member State competent authorities to collect such information. That is, there should not be any concern on the part of the FSA that the FSA is somehow delegating away its responsibility to another regulator such as the SEC.

Finally, given the size of the alternative investment industry in the U.S. and the likely impact of the AIFMD on US AIFMs, MFA would urge the FSA to impress on ESMA the need for direct cooperation with the SEC in order to produce workable solutions in relation to the reporting of information.

Confidentiality

MFA understands the importance of market participants providing information to competent authorities so they can determine whether there are potential risks in the financial system. However, because much of the information being provided to the FSA and other Member State regulators will be sensitive and/or proprietary, it is critical that such information be kept confidential, both by regulators receiving the information, and any other regulatory body who may otherwise receive such information (such as ESMA and the ESRB).

MFA considers that confidentiality is of great importance to AIFMs and the effective working of the alternative investment fund industry as a whole. Public disclosure, even if inadvertent or delayed, of highly sensitive, proprietary business information would result in immediate and irreversible damage to the competitive position of a fund and its investors.

MFA has raised similar concerns with the SEC in respect of the Dodd-Frank Act implementation. In the U.S., information that fund managers submit on Form PF will be subject to important confidentiality protections under Section 404 of the Dodd-Frank Act. MFA strongly supports these protections and asked that ESMA look to adopt a similar approach. MFA encourages regulators to develop robust measures to ensure that confidential information is not disclosed.

CHAPTER 7 – DEPOSITARY

Who can be a depositary?

Question 38: While a depositary is a feature of FSMA-authorised funds (including NURS), the requirement to ensure the appointment of a depositary for unregulated CIS represents a change for UK AIFMs. What additional costs and benefits might this change give rise to?

MFA's primary concern lies with the increased costs that are likely to be imposed on the depositary industry and which are likely to be passed on to the end users of such depositary services; i.e. the AIFMs.

Question 39: Should the capital requirements for depositaries within the third bullet of paragraph 7.3 of this DP be increased and, if so, what approach should be taken? What role could insurance have in supplementing this requirement? Where the depositary is within a group, to what extent would a parent stand behind its subsidiary in the case of a default and/or loss of assets?

No comment.

Question 40: Are there any bodies (e.g. lawyers, accountants or fund administrators) that intend to offer depositary services to the type of AIF in paragraph 7.7 of this DP? What would be an appropriate prudential regime for these types of depositary and what level of financial or professional guarantees should be given? Should we apply any other FSA requirements to these depositaries?

No comment.

Duties of a depositary – Cash monitoring

Question 41: Do you agree with our view that a depositary, in having to meet its existing FSA requirements, may already be carrying on most or all of the Directive requirements in relation to monitoring cash flow? If you disagree, what costs and benefits do you consider the Directive requirements will impose?

No comment.

Duties of a depositary – Safe-keeping of AIF assets

Question 42: What other categories of assets would not be required to be registered by the depositary in a segregated account?

No comment.

Question 43: Do you agree that no additional guidance is required for the verification of assets, and it is appropriate for the depositary to exercise its professional judgement to assess what information is required in different circumstances? If not, what assets do you consider need further guidance and what steps do you consider relevant to verify ownership of those assets?

No comment.

Duties of a depositary – Requirements for UK AIFM marketing non-EU AIF

Question 44: When carrying out their valuation oversight duties, how will depositaries ensure that the valuation procedures are appropriate with regard to the nature, scale and complexity of the AIF under management?

No comment.

Question 45: Do you consider that those entities performing the primary depositary functions should be acting independently of the AIFM and not be part of the same group as the AIFM? What are the implications of such an interpretation?

No comment.

Question 46: What is the appropriate regulatory treatment for firms that carry on one or more of the three primary depositary functions for non-EU AIFs? Are there industry codes or principles of best practice that these firms should adhere to?

No comment.

Duties of a depositary – Segregation of assets by a sub-custodian

Question 47: In which jurisdictions does national law not recognise the segregation of assets during insolvency proceedings? What actions are currently undertaken in such circumstances to mitigate this risk?

No comment.

Question 48: ESMA's advice sets out some options about how to minimize the risk of loss in such jurisdictions. Are there any other arrangements that could be used to minimise the risk of loss in such jurisdictions?

No comment.

Depositary liability

Question 49: What are the main changes that depositaries will have to take account of given the requirements in relation to depositary liability? What are the estimated direct and indirect costs of these changes?

No comment.

CHAPTER 8 – MARKETING

What is marketing? – Marketing on behalf of a UK AIFM

Question 50: It is possible that the Commission with national regulators may consider the definition of 'marketing' in AIFMD transposition workshops during 2012. With this in mind, which marketing practices do you consider may be within the definition of 'marketing' in article 4(1)(x) of the Directive? Which practices should not be considered as 'marketing'?

The definition of "marketing" in the AIFMD specifically refers to an offering or placement "at the initiative of the AIFM"; reverse solicitation is therefore not considered to be "marketing" under the AIFMD. MFA believes that, where an AIFM is approached by a potential investor under a reverse solicitation process, for example in relation to an AIF, any marketing by the AIFM of further units that may be issued by that AIF or of units of any further AIF managed by the AIFM should be covered by the initial reverse solicitation.

Question 51: Which material factors should also be considered when determining whether the activity of offering or placement of units or shares in an AIF falls within the Directive 'marketing' definition?

As the FSA recognizes, there are different ways in which AIFs may be marketed. As a general statement, MFA would note that an activity should be considered to be "marketing" under the AIFMD only when the activity is specific enough to relate to a particular AIF. The FSA should make clear that generic marketing of investment funds (e.g. a meeting in which an AIFM's general investment strategy is discussed with a potential investor) should not be considered to be "marketing" since no specific AIF units/shares are being marketed.

The FSA also notes in paragraph 8.8 of the Discussion Paper that in some cases an AIFM may be providing MiFID investment services such as "investment advice" or "reception and transmission of orders in relation to one or more financial instruments" when distributing AIF. MFA is of the view that there should be a clear distinction between "marketing" on the one hand and those MiFID investment services; there should not be any presumption that when a person (whether an AIFM or MiFID firm) is providing those MiFID services in relation to any AIF, that person is necessarily engaging in "marketing" under the AIFMD. Equally, there should not be a presumption that "marketing" is necessarily always accompanied by those MiFID services.

Question 52: What else should we consider concerning the 'on behalf of the AIFM' element of the 'marketing' definition?

As the FSA will be aware, there will be a need to ensure that the current FSA rules relating to financial promotion, in particular under the Financial Promotion Order, the Promotion of Collective Investment Schemes Order and the Conduct of Business Sourcebook, will be consistent with what is contemplated under the AIFMD. For example, it is possible that, under certain distribution arrangements, the distributor is not an agent of the AIFM; where that is the

case, the distributor might not be considered to be offering or placing units or shares of AIFs "on behalf of the AIFM" under the definition or "marketing". This situation could arise, for example, where the AIF is being marketed through private banking networks.

Private placement

Question 53: Should we create a distinct register or list for those non-EU AIFMs from whom we have received a notification of intention to market an AIF in the UK through national private placement?

MFA supports the creation of such a register or list. Such a register or list will give investors in a particular Member State (in this case the UK) an indication that the relevant non-EU AIFM is marketing in compliance with the AIFMD framework. MFA would also encourage the FSA to discuss with ESMA the possibility of having a single EEA register or list so that it will be possible for investors to see, at a glance, all of the Member States for which an AIFM has notified the competent authority of its intention to market AIFs in those Member States.

Public offers of listed AIFs

Question 54: Do you agree that those listed AIFs marketed by virtue of a public offer are undertaking the activity of 'marketing' as defined in the Directive and are therefore subject to the relevant requirements?

No comment.

CHAPTER 9 – CATEGORIES OF AIF AND SPECIALISED REGIMES

MFA does not propose to provide responses to the questions in this section.

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