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

January 8, 2015

Via *ESMA Website*

European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris
France

Re: Call for Evidence: AIFMD Passport and Third Country AIFMs

Dear Sir or Madam:

Managed Funds Association ("MFA")[1] welcomes the opportunity to provide comments to the European Securities and Markets Authority ("ESMA") in response to its call for evidence -- AIFMD Passport and Third Country AIFMs (the "Call for Evidence"). Throughout the process of drafting and implementing the Directive on Alternative Investment Fund Managers (the "AIFMD"), MFA engaged constructively with EU and Member State policy makers and regulators on a number of important issues. We welcome the opportunity to continue to work with ESMA further in this regard. Please note that we have not responded to all the questions in the Call for Evidence.

MFA and its members have consistently supported the policy goals underlying the AIFMD and strongly support regulatory oversight for hedge fund managers. We remain concerned, however, with several specific provisions in the AIFMD, as well as varying Member State regulations applicable to the marketing of hedge funds, which are discussed in more detail below. As a result of the compliance costs and legal uncertainty associated with the AIFMD, many non-EU managers have decided not to market their funds to EU investors under the private placement framework. Based on industry surveys and feedback from MFA members, we believe that many non-EU managers also would be unlikely to market funds to EU investors under a passport regime.

Given the very short time between the AIFMD becoming fully implemented (22 July 2014) and the ESMA having to deliver its opinion and advice (by 22 July 2015) (and the Commission adopting a delegated act within 3 months thereafter), we believe that regulators and policy makers should consider a longer review period before making any recommendations on the functioning of

[1] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

the private placement and passport regimes, to better ensure there is sufficient information on which to base such recommendations.

Importance of Capital Markets

Before discussing the questions in the Call for Evidence and MFA's specific concerns with the AIFMD private placement and passport frameworks, it is important to note that capital markets are a valuable and vital source of funding for businesses and the functioning of the economy. As European Commission President Jean-Claude Juncker stated in a July 2014 speech to the European Parliament:

> "To improve the financing of our economy, we should further develop and integrate capital markets. This would cut the cost of raising capital, notably for [small and medium sized enterprises], and help reduce our very high dependence on bank funding. This would also increase the attractiveness of Europe as a place to invest."[2]

MFA and its members agree with President Juncker's views about the importance of capital markets and private sector investment, in Europe and around the world. Hedge funds, among other market participants, are key investors in capital markets, as well as key providers of risk-adjusted investment returns, diversification, and risk management for institutional investors. In particular, non-EU hedge fund managers are often themselves active in investing in Europe. While we are strong proponents of well-regulated capital markets and market participants, including hedge fund managers, we are concerned that the AIFMD creates disproportionately high compliance costs and uncertainty, both of which act as a disincentive to non-EU hedge fund managers. We believe this result is inconsistent with President Juncker's call for further development of EU capital markets. We further believe that a revised approach to the AIFMD, taking into considerations specific concerns discussed below, would better achieve the shared policy goals of a strong regulatory framework for hedge fund managers and stronger capital markets.

Questions in the Call for Evidence

MFA's primary focus relates to Section 2.3.2 (*Question on the functioning of the national private placement regimes*). In particular, our thoughts and observations below relate to the following questions in that Section:

> Q7: Please describe the activity of your organisation in the EU […]
>
> Q15: What have been the benefits of the National Private Placement Regimes (NPPR) to you?
>
> Q16: What have been the obstacles or barriers to entry of the NPPR to you?
>
> Q17: What obstacles did you encounter when trying to register through the NPPR?
>
> Q18: What have been the costs?

[2] The full text of President Juncker's speech is available at: http://ec.europa.eu/about/juncker-commission/docs/pg_en.pdf.

Q19: Have you exited countries since the entry into force of the AIFMD NPPR – and if so, why?

Q20: Have you been deterred from undertaking private placement, and if so why?

Marketing by Non-EU Managers

In July 2014, Preqin conducted a study[3] of how non-EU managers are responding to the AIFMD. The study found that the vast majority of non-EU managers, with the exception of managers in Switzerland (which has adopted legislation similar to the AIFMD), do not plan to market their funds to EU investors, either through national private placement regimes or through the AIFMD passport (should it become available) over the next 12-18 months.

With respect to U.S. managers, only 12% of managers indicated that they plan to market under national private placement regimes, and only 4% plan to establish an EU AIFM to take advantage of the AIFMD passport. Based on our anecdotal experience with MFA members, we do not believe that there would be substantially more interest from U.S. managers in becoming fully authorised AIFMs to be able to market under the AIFMD passport if it were expanded to non-EU AIFMs. Similarly, the Preqin study found that only 9% of non-EU managers outside of Switzerland and the U.S. plan to market under national private placement regimes, and only 9% plan to establish an EU AIFM to take advantage of the AIFMD passport.

The Preqin study found that 78% of U.S. managers cited compliance costs or uncertainty about the AIFMD as the reason why U.S. managers do not plan to market their funds to EU investors. The study found that 42% of non-EU managers outside of Switzerland and the U.S. cited compliance costs or uncertainty about the AIFMD as the reason that they do not plan to market to EU investors. Similarly, a June 2014 survey by Aksia found that a majority of hedge fund managers do not plan to market to EU investors and 87% of managers responded that they have faced significant challenges regarding the AIFMD.[4]

Taken together, the Preqin and Aksia studies confirm what we have heard anecdotally from members; that compliance costs and legal uncertainty under the AIFMD are providing a significant disincentive to non-EU managers to operate in or market to EU investors. This is particularly true because non-EU managers must make a decision on whether to undertake the legal and compliance costs of complying with the AIFMD prior to knowing whether they will receive any investor subscriptions as a result of marketing efforts that bring the manager within the scope of the AIFMD. Set out below is a discussion of some of the specific issues that we believe are key concerns of non-EU managers.

[3] The full text of the Preqin report is available at: https://www.preqin.com/docs/reports/Preqin-Special-Report-Hedge-Fund-Managers-Respond-to-AIFMD-July-14.pdf. We note that MFA is not associated with Preqin

[4] The full text of the Aksia report is available at: http://www.aksia.com/media/2015_HF_Manager_Survey.pdf. We note that MFA is not associated with Aksia.

National Private Placement Regimes

While our members appreciate the ability for non-EU AIFMs to market their funds in the EU without being subject to full authorisation under the AFIMD, the resulting national private placement regimes have led to duplication, inconsistencies and potential conflicts. Moreover, there remain a number of Member States that do not have private placement regimes for hedge funds, creating further inconsistency for marketing of hedge funds and other alternative investment funds. The significant uncertainty resulting from a lack of guidance and clarity regarding the rules in different Member States is complicated and costly, which we believe has acted as a disincentive to U.S. managers wishing to raise capital from EU investors thus inhibiting cross border capital flows and limiting investor choice.

One of the specific concerns for U.S. managers relates to the reporting forms under the AIFMD (Annex IV).[5] The reporting requirements in individual Member States, combined with a lack of guidance, create additional burdens for managers who want to market in more than a single Member State. These disparities also inhibit the ability of regulators to compare the reported information. In this regard, we note that ESMA's Opinion to Member States,[6] which encouraged Member State regulators to require reporting of certain information beyond what is required in the template form (*e.g.*, VaR reporting, reporting on HFT, reporting of non-EU master AIFs that are not marketed into the EU), is one example of how the implementation of the reporting requirements under the AIFMD has created uncertainty and complexity for managers.

We encourage ESMA and Member State regulators to continue to consider the best framework for reporting by hedge fund managers, including the timeframes for reporting (we note, for example, that managers have 60 days after the reporting period in the U.S. compared to 30 days after the reporting period in the EU), to achieve a balance between ensuring regulators have access to the information they need for oversight purposes, on a non-public and confidential basis, and avoiding unnecessary burdens on managers.. We believe that such an approach not only reduces unnecessary burdens on the industry; it increases the ability of regulators to use and analyze the information they are collecting.

Extension of AIFMD Passport

General Views on AIFMD Passport for Non-EU Managers

As noted by the Preqin study cited above, a significant majority of non-EU managers do not intend to market to EU investors under national private placement regimes or establish an EU AIFM to take advantage of the AIFMD passport. Consistent with those survey results, we have heard anecdotally from members that there is not significant interest from non-EU managers in becoming fully authorised AIFMs if the EU extended the AIFMD passport to non-EU managers.

In light of the remaining uncertainty and other concerns non-EU managers have with respect to the AIFMD, and the likelihood that many non-EU managers will not seek to market to EU investors under the passport, we encourage policy makers conduct a longer review period before

[5] MFA has raised similar concerns with U.S. regulators about the reporting forms for private fund managers.

[6] ESMA/2013/1340 of 1 October 2014.

making any recommendations on the functioning of the private placement and passport regimes, to better ensure there is sufficient information on which to base such recommendations. Set out below are some of the key concerns with the AIFMD, which we believe should be the focus of regulators and policy makers, each of which MFA has raised previously during the various stages of implementation of the AIFMD. We also encourage EU and non-EU regulators and policy makers to continue to harmonize their regulatory requirements for managers and to facilitate compliance by deeming managers that comply with their home jurisdiction rules to be in compliance with similar rules in other jurisdictions; provided that the rules are designed to achieve equivalent outcomes. While we recognize that such an approach involves significant challenges for regulators, we believe that this approach to hedge fund manager regulation and oversight will best accomplish the policy goals of regulating managers and encouraging private capital participation in capital markets across borders.

Remaining Areas of Concern in AIFMD

We note that there are a number of remaining concerns regarding language in the AIFMD Level 1 and Level 2 text, which were raised during the Level 1 and Level 2 processes. We believe it is important for regulators and policy makers to continue to consider ways to address these concerns, particularly in light of the fact that many non-EU managers have identified AIFMD compliance as a key disincentive to operating in the EU or marketing to EU investors.

Calculation of Leverage

We remain concerned with the Level 2 text, which provides that three times a fund's net asset value is the simple threshold for whether a fund uses leverage on a substantial basis, particularly to the extent this approach might be used as precedent in other directives or regulations for purposes other than triggering a reporting requirement. We believe that a one-size-fits all threshold for funds does not provide an accurate measurement by which to compare the use of leverage by funds across the financial system. Whether leverage is being employed on a substantial basis depends on a number of factors, including the type of fund, the nature of the assets, and the investment strategy being followed.

We appreciate the language in the recitals of the main Level 2 Regulation (No 213/2013), which would permit the Commission to adopt further delegated acts allowing AIFMs to use an additional and optional method for the calculation of leverage, such as the Advanced Method. While we understand the desire to use the Gross and Commitment Methods for consistency, we believe a balanced approach that includes additional reporting methods will provide more accurate reporting of leverage in addition to the harmonized reports and will promote greater consistency and harmonization in reporting templates in different jurisdictions. Enhanced consistency and harmonization will increases the ability of regulators to compare information collected in different jurisdictions and reduce the costs and burdens on fund managers.

Appointment of Counterparties

We remain concerned that the Level 2 regulation may preclude many typical over-the-counter ("OTC") transactions that funds enter into because these transactions often are with entities that are not directly subject to supervision, but are affiliated with supervised entities (*e.g.*, an affiliate of a regulated prime broker). As such, we believe that the text should be clarified to ensure that a

manager or fund may enter into a transaction with a counterparty that is an affiliate of a regulated prime broker if the transaction is entered into in connection with a contract with the regulated entity (*e.g.*, the prime brokerage agreement or ISDA agreement entered into with the regulated prime broker).

Proportionality

We note and appreciate that the Level 2 text incorporated the principle of proportionality with respect to some key provisions, such as risk management. We believe the Level 2 text should be amended to clarify that the principle of proportionality applies across the scope of the AIFMD.

Remuneration

ESMA has published Guidelines on sound remuneration policies under the AIFMD. We are concerned about applying remuneration principles originally intended for banks and other large financial institutions to hedge fund managers. In that light, we believe it is important for policy makers to reconsider the approach to remuneration under the AIFMD, both with respect to the requirements on how a manager may structure its remuneration agreements and with respect to requiring managers to report and disclose sensitive information about their remuneration practices, to avoid unintended consequences, such as: conflicts in law across jurisdictions; creating tax liabilities for employees beyond cash remuneration amounts actually paid in a given year; misaligning incentives between fund manager employees and fund investors; and potentially harmful disclosures about a manager's sensitive information.

Depositaries

The AIFMD requirements on depositaries and delegates who maintain custody of hedge fund assets create significant operational challenges and costs for managers and go beyond current market practices developed based on custody rules in many jurisdictions. We believe regulators should seek to achieve greater harmonization of custody rules across jurisdictions to avoid inconsistencies that can lead to greater operational complexity and increased cost, without providing additional protections for funds or their investors.

Additional Member State Requirements

One additional area of concern for non-EU managers beyond the text of the AIFMD is the additional layers of regulation or restriction by individual Member States that act as a barrier to entry for many non-EU managers and their funds. We understand that certain Member States have imposed additional requirements on EU AIFMs that seek to market their AIFs into those Member States. To the extent the AIFMD passport is extended to non-EU managers, we believe it is critical that individual Member States not impose additional regulatory or other restrictions on the ability of non-EU managers to market their funds to EU investors. Such restrictions would undermine the value of the AIFMD passport for those managers seeking to use that approach to market to EU investors and also wold undermine the goal of a harmonized regulatory framework across the EU. We encourage ESMA work with European and Member State policy makers to ensure that there are no such barriers to entry before any determination to extend the AIFMD passport to non-EU managers.

Conclusion

MFA and its members continue to support the policy goals underlying the AIFMD and strongly support regulatory oversight for hedge fund managers. We appreciate that our comments may require reconsideration of significant aspects of the AIFMD. We remain concerned, however, that, for the reasons discussed above, many non-EU managers have decided not to market their funds to EU investors under the national private placement framework and are unlikely to market funds to EU investors under a passport regime in the near term. Short term, we recommend EU policy makers conduct a longer review period before making any determinations about the passport to provide both managers and policy makers the necessary time to gather and analyze more evidence on which to make an informed decision. Longer term, we believe an approach that would better achieve the dual policy goals of regulating hedge fund managers and developing stronger and deeper capital markets would be for EU and non-EU regulators and policy makers to continue to facilitate compliance by deeming managers that comply with their home jurisdiction rules to be in compliance with similar rules in other jurisdictions; provided that the rules are designed to achieve equivalent outcomes. If the AIFMD is to achieve its objective of effectively regulating a dynamic European hedge fund industry that attracts global capital, strengthens the EU's capital markets, and helps institutional and other sophisticated investors achieve their investment goals, we respectfully suggest that it is important for policy makers to consider addressing the concerns outlined in this letter.

We would be very happy to discuss our comments or any of the issues raised in the Call for Evidence with ESMA. If ESMA 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

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Managing Director, General Counsel