
Alternative Investment Fund Managers Directive.

Survival Kit

July 2013



Notice.

This survival kit has been prepared on the basis of the following documents:

- > EU Directive 2011/61/EU on Alternative Investment Fund Managers dated 8 June 2011
- > EU Commission Delegated Regulation of 19 December 2012 supplementing Directive 2011/61/EU
- > ESMA Guidelines on sound remuneration policies under the AIFMD (Final report) of 11 February 2013
- > EU Commission “Q&A” released on 27 March 2013
- > ESMA Guidelines on key concepts of the AIFMD (Final report) released on 24 May 2013
- > ESMA Consultation Paper on ESMA’s guidelines on AIFMD reporting obligations of 24 May 2013

Outline.

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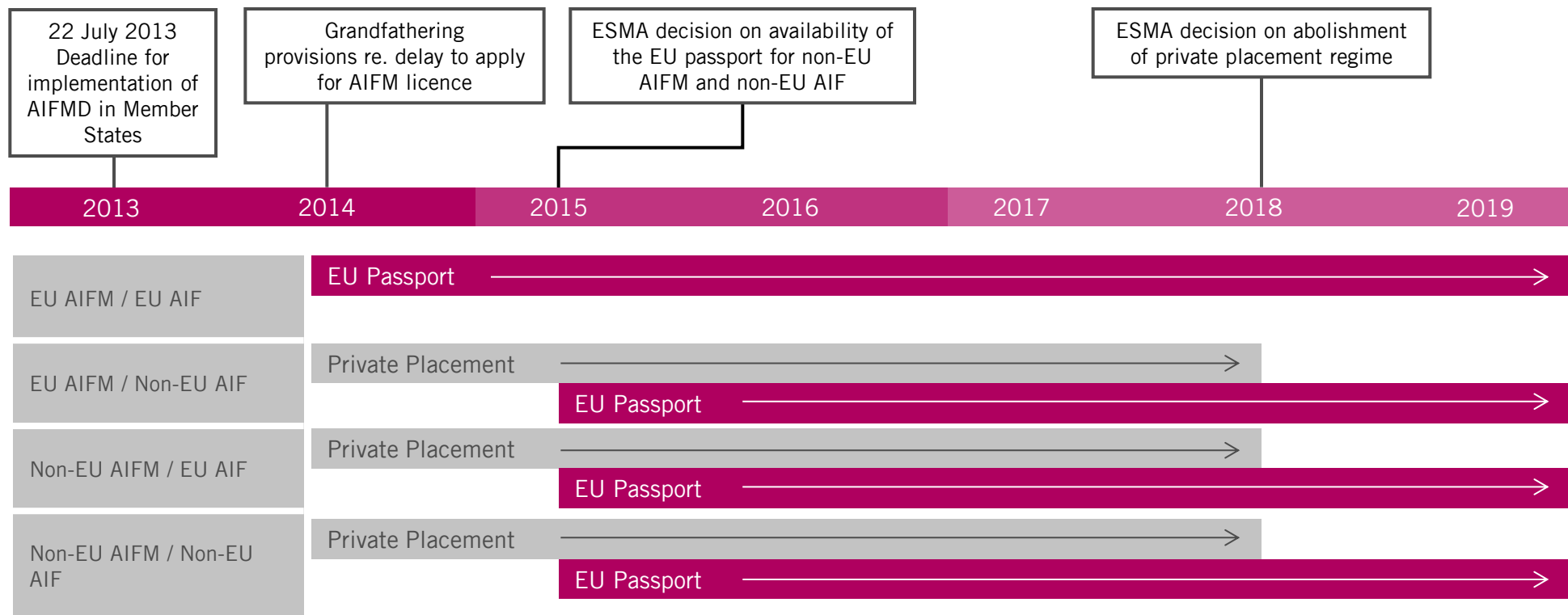


Origin, timeline & scope.

Origin.

- > A direct consequence of the conclusions of the G-20 Summit in November 2008
- > Alternative Investment Fund Manager (“AIFM”) will need to apply for authorisation in order to manage Alternative Investment Fund (“AIF”)
- > In return, AIFMD introduces a “passport” enabling AIFMs to offer their management services and market their AIFs throughout the EU

Timeline.



This diagram aims to provide a global vision of the various regimes available over time and their implications, in terms of level of requirements, for both EU managers and non-EU managers. It should be read along with the following tables

Scope.

AIF means:

any collective investment undertaking other than UCITS
 which raises capital from a number of investors (i.e. at least two)
 with a view to investing for the benefit of those investors in accordance with a defined investment policy.

AIFM means:

legal persons whose regular business is to manage one or more AIF.

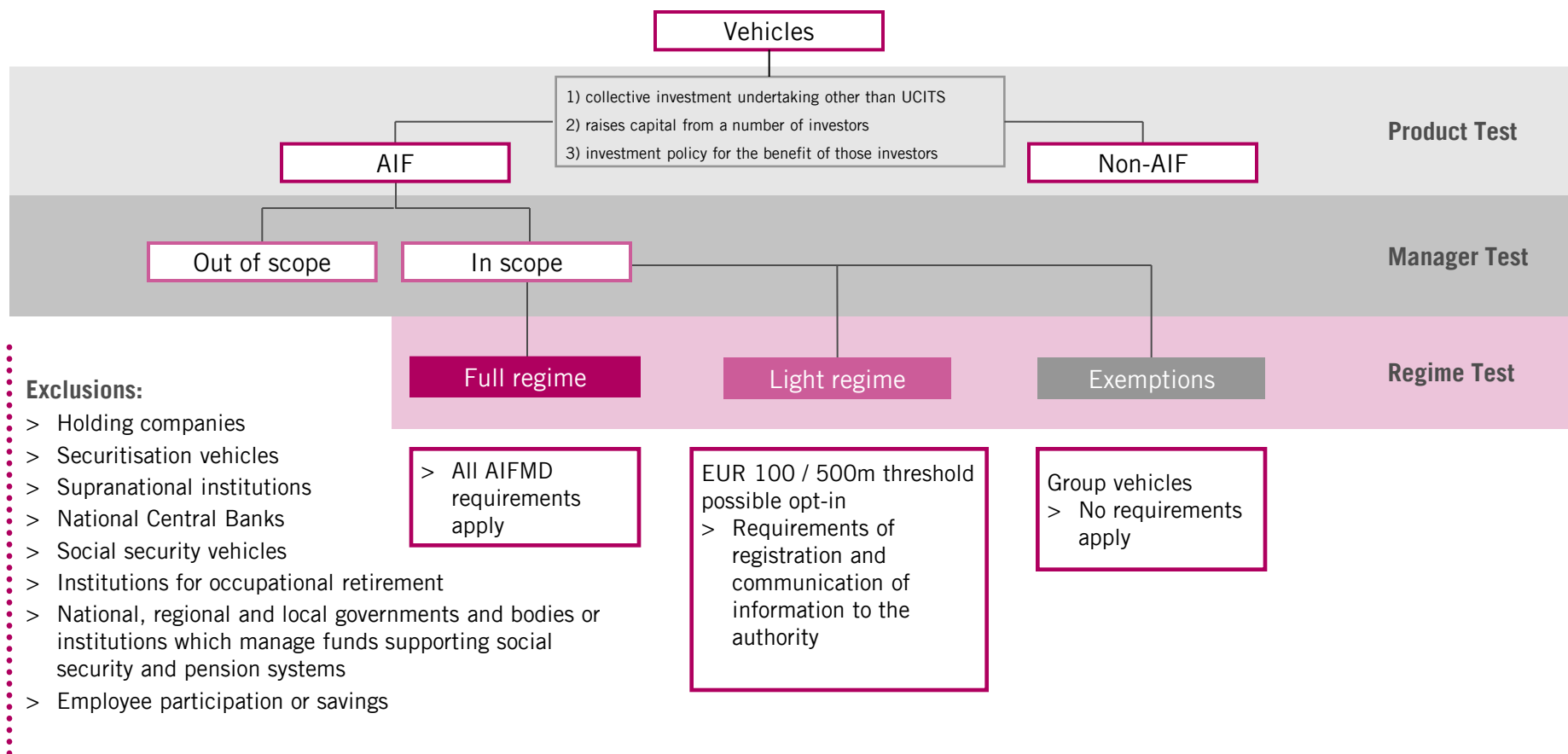
In scope	Out of scope	Exemptions
<ul style="list-style-type: none"> > EU AIFM managing EU or non-EU AIF > Non-EU AIFM managing EU AIF > Non-EU AIFM marketing EU or non-EU AIF within the Union 	<ul style="list-style-type: none"> > Holding companies > Institutions for occupational retirement > Supranational institutions (ECB, EIB, EIF, FSB, EBRD, IMF, World Bank...) > Luxembourg Central Bank and other national Central Banks > National, regional and local governments and bodies or institutions which manage funds supporting social security and pension systems > Employee participation or savings > Securitisation vehicles* > AIFM managing closed-ended AIFs existing before 22 July 2013 which do not make any additional investments after 22 July 2013 > AIFM managing closed-ended AIFs whose investment period ended before 22 July 2011 and whose term will not exceed 22 July 2016 (only subject to the AIFMD provisions related to the annual report) <p>But also:</p> <ul style="list-style-type: none"> > Insurance contracts** > Family offices** > Joint ventures** 	<ul style="list-style-type: none"> > Group vehicles > Lux AIFM managing leveraged AIFs and AuM of less than EUR 100m > Lux AIFM managing unleveraged AIFs, no redemption for 5 years and AuM of less than EUR 500m > Lux AIFM may opt-in under the Draft Law

* provided their activities are covered by ECB regulation 24/2009
 ** provided that they do not meet the requirements of article 4(a) of the Directive

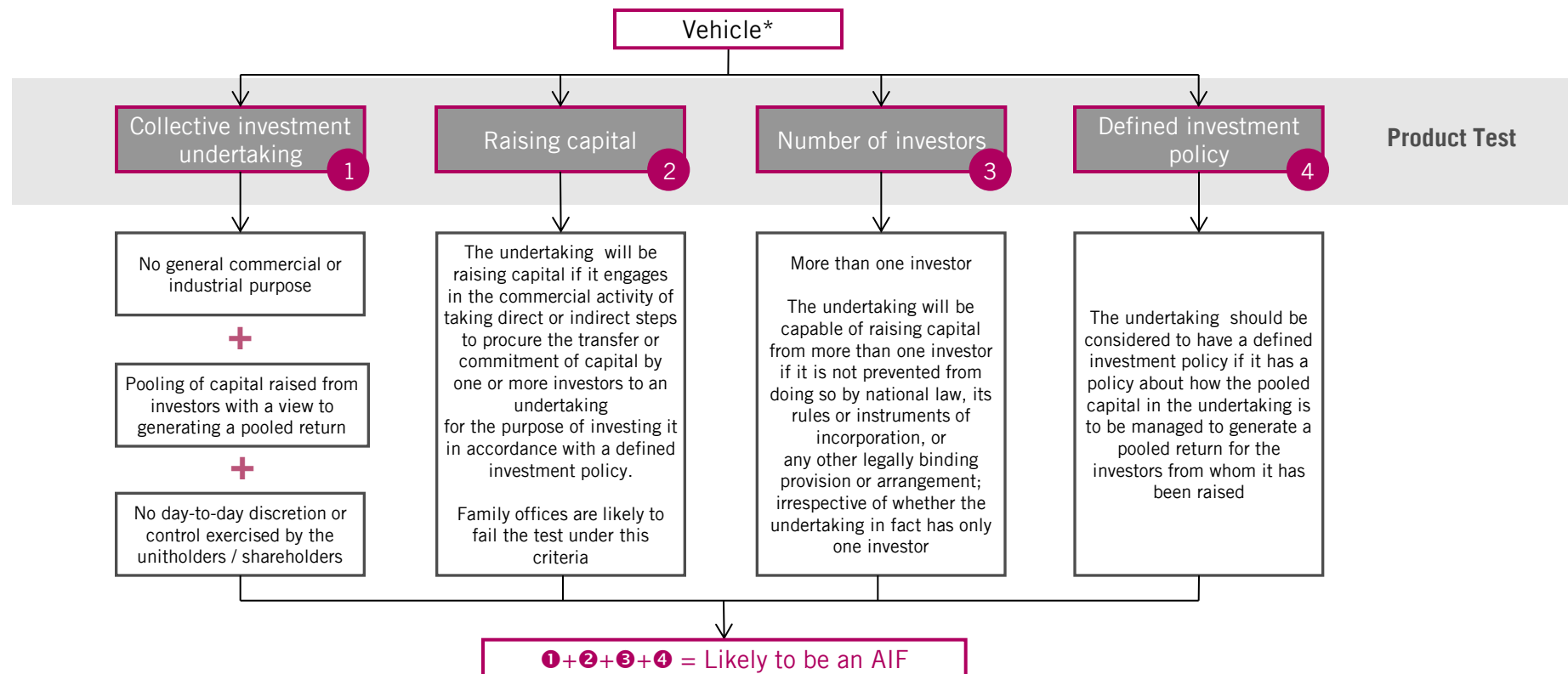
What does this mean for Luxembourg?

	Vehicle	In / Out of scope
AIF	Part II UCI	In scope
	SIF	In scope – unless dedicated to a single investor in its constitutional and/or issue document
	SICAR	In scope – unless dedicated to a single investor in its constitutional and/or issue document
	Unregulated investment vehicle	Out of scope – unless it meets the conditions laid down in the definition of AIF
	Securitisation vehicle	Out of scope – provided it carries out activities which are covered by ECB Regulation 24/2009
	ASSEP / SEPCAV (pension funds)	Out of scope
AIFM	Chap 15 Manco	In scope if (i) it manages AIF and (ii) it has not appointed an external AIFM
	Chap 16 Manco	In scope if (i) it manages AIF and (ii) it has not appointed an external AIFM
	Self-managed AIF	In scope
	Managing GPs of SCA and SCS	Out of scope – unless it manages more than one SCA / SCS
	Discretionary portfolio manager	Out of scope
	Managers of non-coordinated foreign UCIs	To be abolished on 22 July 2014
	New sui generis AIFM status	In scope

Tests.



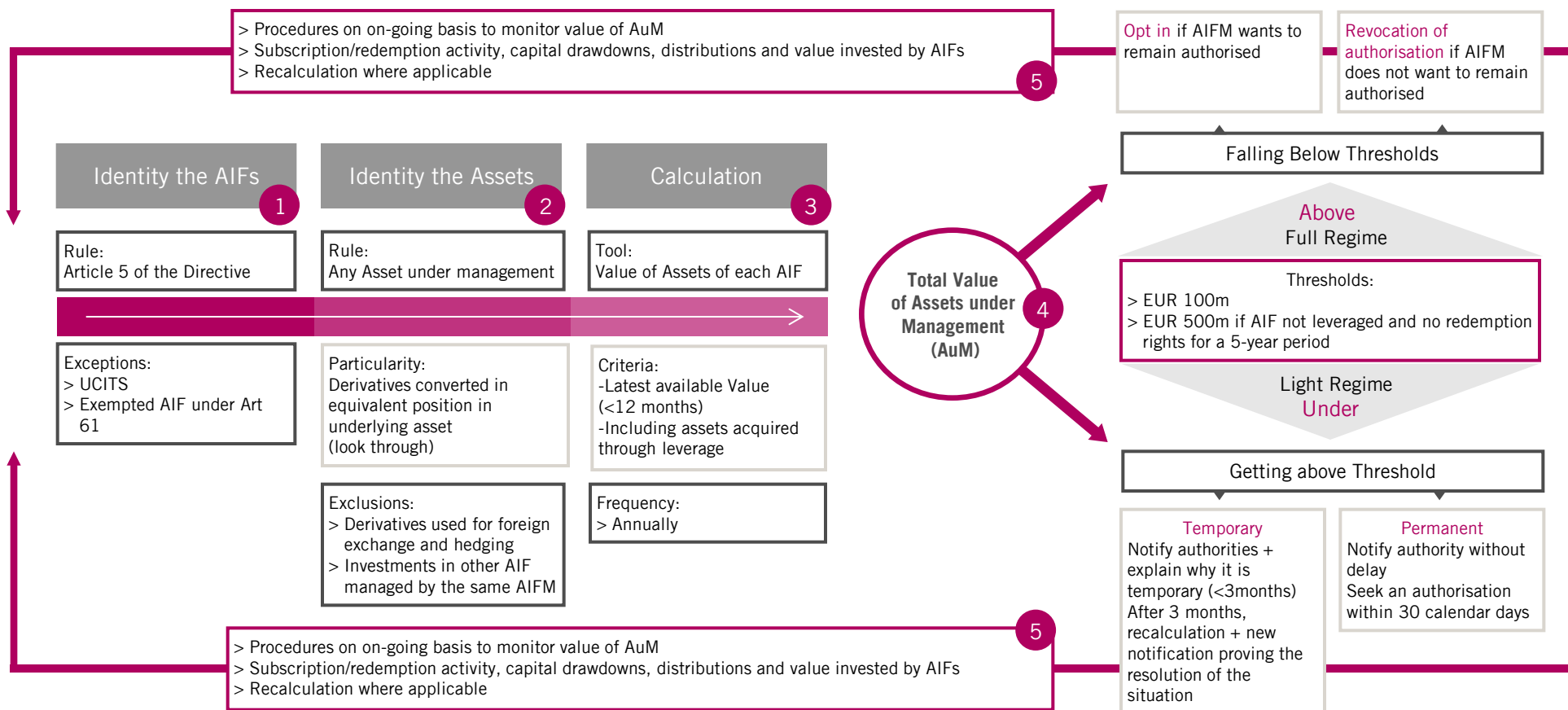
AIF “Product test”.



* Other than UCITS and exempted vehicles under article 2(3) of the Directive.

Please note that there is no binding exemption of joint ventures and insurance contracts (which are merely referred to in the Recitals of the Directive). However, these schemes will likely fail the product test in relation to either shareholders exercising day-to-day control or the undertaking raising capital

Are you below or above the thresholds?



Geographical scope.

- > **AIFMD regulates all AIFMs (EU or non-EU) managing or marketing AIFs (EU or non-EU) in the EU**
- > **AIFMD is not applicable to non-EU AIFMs which manage non-EU AIFs marketed outside the EU**
- > **Pitfalls:**
 - > Risk of unlevel playing field re. private placement regime
 - > Absence of reciprocity principle in AIFMD



Determination of the AIFM.

Determination of the AIFM.

You will be characterised as an AIFM if you carry out at least:

- > Portfolio management
- > Risk management

In addition, an AIFM may also provide:

- > Administration
- > Marketing
- > Activities related to the assets of AIF

Two options:

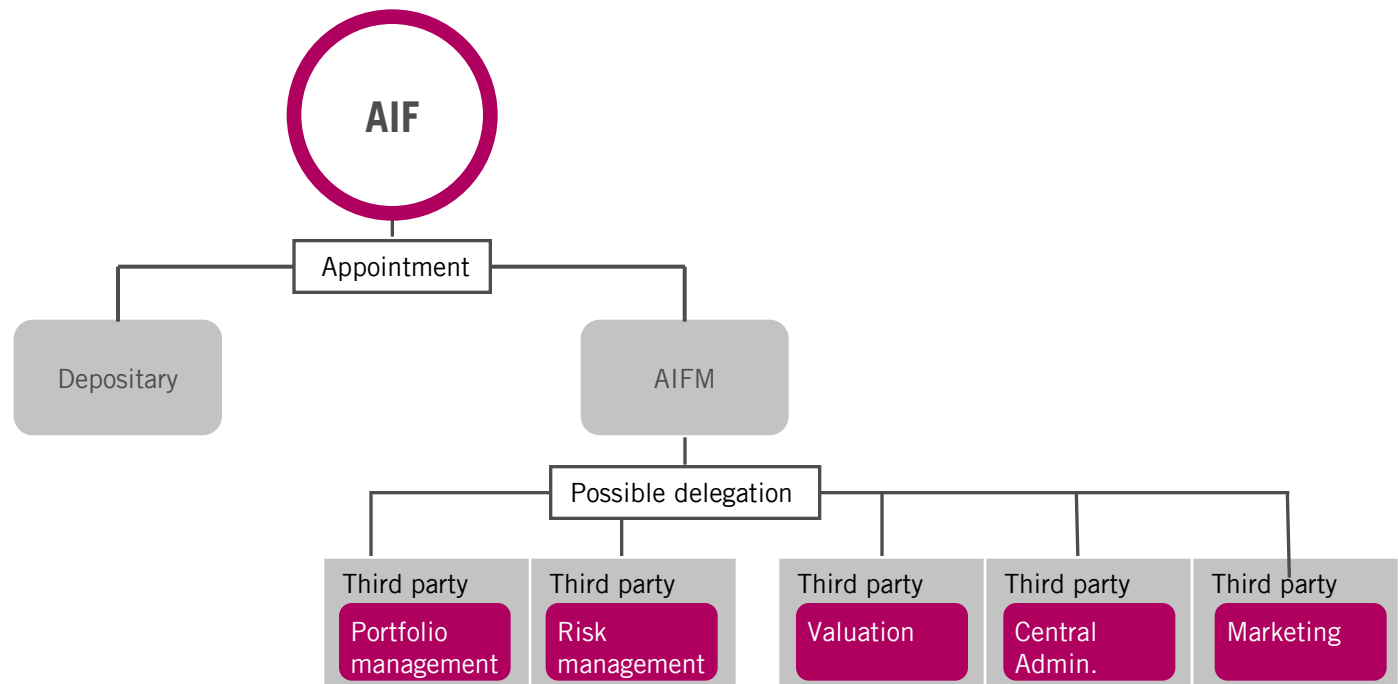
- 1) The AIFM can be an external manager appointed by or on behalf of the AIF
- 2) The AIFM can be the AIF itself (“self-managed AIF”) provided that:
 - > The legal form of the AIF permits internal management (e.g., SICAV)
 - > The AIF’s governing body chooses not to appoint an external AIFM



Management structures: External manager.

An AIF which appoints an external manager as AIFM

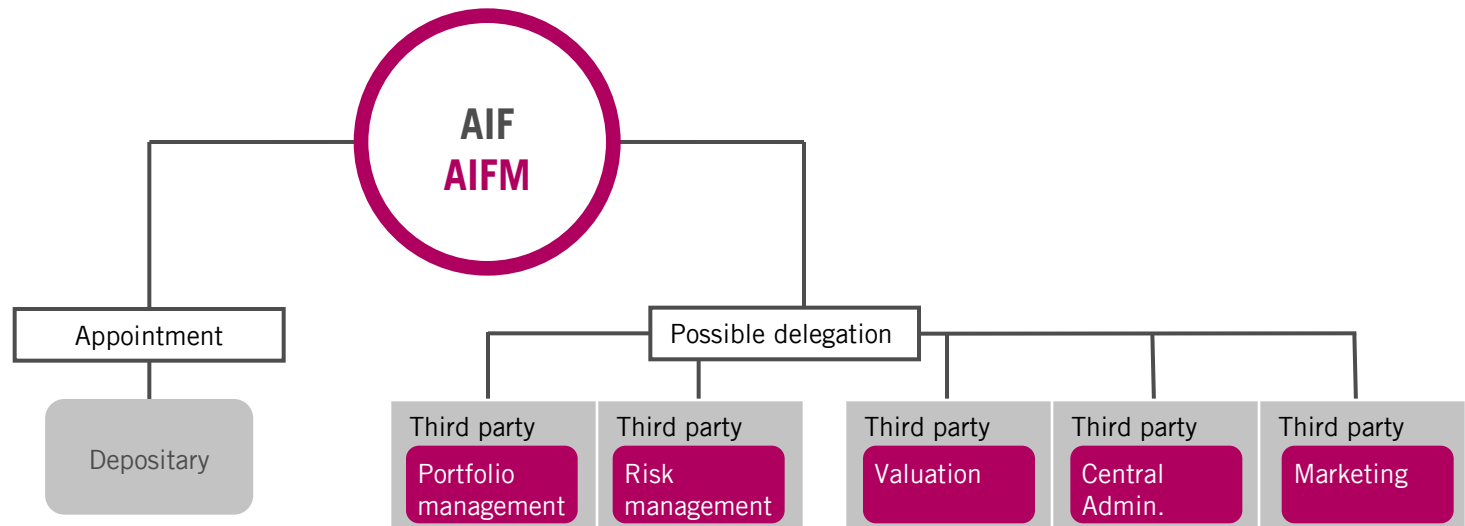
- > which may delegate the portfolio management, risk management, valuation and/or central administration functions subject to delegation restriction
- > which ensures a single depositary is appointed



Management structures: Self-managed AIF.

A self-managed AIF

- > which may delegate the portfolio management, risk management, valuation and/or central administration functions subject to delegation restriction
- > which appoints an entity to provide depositary service



EU passport/Private Placement.

EU passport.

- > **AIFMD provides for two types of passport:**
 - > EU marketing passport
 - > EU management services passport



EU marketing passport.

AIFM	AIF	EU marketing passport	Depository	Valuation	AIFMD requirements
EU	EU	Yes * From 2013	Yes Location: home member state of AIF	Yes	Compliance with full AIFMD
EU	Non-EU	Yes From 2015**	Yes Location: country of AIF or home member state of AIFM	Yes	<p>Compliance with full AIFMD except provisions re “rights of EU AIFM to market and manage EU AIF in EU”</p> <p>Cooperation in place between home member state of AIFM and country of AIF</p> <p>Country of AIF is not on FATF non-cooperative countries list</p> <p>Country of AIF has signed OECD Model Tax Convention for exchange of information with home member state of AIFM and each member state where AIF is marketed</p>

* If the feeder is an EU AIF and the master is a non-EU AIF: no EU passport available

** subject to ESMA's prior analysis and approval

EU marketing passport (cont'd).

AIFM	AIF	EU marketing passport	Depository	Valuation	AIFMD requirements
Non-EU	EU	Yes From 2015*	Yes Location: home member state of AIF	Yes	<p>Compliance with full AIFMD except provisions re “rights of EU AIFM to market and manage EU AIF in EU”</p> <p><u>Requirements for authorisation of non-EU AIFM:</u></p> <p>AIFM has a legal representative in its member state of reference</p> <p>Cooperation in place between member state of reference of AIFM, member state of AIF and country of AIFM</p> <p>Country of AIFM is not on FATF non-cooperative countries list</p> <p>Country of AIFM has signed OECD Model Tax Convention for exchange of information with member state of reference of AIFM</p>
Non-EU	Non-EU	Yes From 2015*	Yes Location: country of AIF or member state of reference of AIFM	Yes	<p>Same as box above and, in addition, re. the AIF:</p> <p>Cooperation in place between member state of reference of AIFM and country of AIF</p> <p>Country of AIF is not on FATF non-cooperative countries list</p> <p>Country of AIF has signed OECD Model Tax Convention for exchange of information with member state of reference of AIFM</p>

* subject to ESMA’s prior analysis and approval

Private placement.

AIFM	AIF	Management and marketing	Private Placement	Depository	Valuation	AIFMD requirements
EU	EU	Yes	No	AIFMD provisions applicable	AIFMD provisions applicable	The manager of the AIF must be authorised as AIFM under AIFMD as from 2014 → Full AIFMD applies
EU	Non-EU	Yes	Yes Until 2018*	AIFMD provisions not applicable but appointment of an equivalent entity in the country of AIF	Yes	Full AIFMD applies except depository provisions Cooperation in place between home member state of AIFM and country of AIF Country of AIF is not on FATF non-cooperative countries list
Non-EU	EU	Yes	Yes Until 2018*	Application of the rules of the member states where AIF is marketed	Valuer subject to national rules applicable to AIF	Compliance with annual report, disclosure to investors and reporting obligation to regulators requirements Compliance with controlling stakes reporting requirements Cooperation in place between member state where AIF is marketed, country of AIFM and member state of AIF Country of AIFM is not on FATF non-cooperative countries list
Non-EU	Non-EU	Yes	Yes Until 2018*	Same as box above	Same as box above	Same as box above + country of AIF is not on FATF non-cooperative countries list

* subject to ESMA's prior analysis and approval

EU management services passport.

AIFM	AIF	EU management services passport	AIFMD requirements
EU	EU*	Yes From 2013	<ul style="list-style-type: none"> > AIFM must be authorised to manage that type of AIF > Communication of information by the AIFM to the competent authority of its home member state (which will transmit it to the competent authority of the host member state of the AIFM) <ul style="list-style-type: none"> 1) Member state in which AIFM intends to manage AIF (either directly or via a branch) 2) Programme of operations stating the services to be performed by AIFM and identifying the AIF it intends to manage > If the AIFM intends to <u>establish a branch</u>, it shall provide additional information: <ul style="list-style-type: none"> 1) Organisational structure of the branch 2) Address in the home member state of the AIF for which documents may be obtained 3) Names and contact details of persons responsible for the management of the branch
EU	Non-EU	N/A	N/A

*established in another member state than the AIFM

EU management services passport (cont'd).

AIFM	AIF	EU management services passport	AIFMD requirements
Non-EU	EU**	Yes From 2015 *	<ul style="list-style-type: none"> > AIFM must be authorised to manage that type of AIF > Communication of information by the AIFM to the competent authority of its member state of reference (which will transmit it to the competent authority of the host member state of the AIFM) <ol style="list-style-type: none"> 1) Member state in which AIFM intends to manage AIF (either directly or via a branch) 2) Programme of operations stating the services to be performed by AIFM and identifying the AIF it intends to manage > If the AIFM intends to <u>establish a branch</u>, it shall provide additional information: <ol style="list-style-type: none"> 1) Organisational structure of the branch 2) Address in the home member state of the AIF for which documents may be obtained 3) Names and contact details of persons responsible for the management of the branch
Non-EU	Non-EU	N/A	N/A

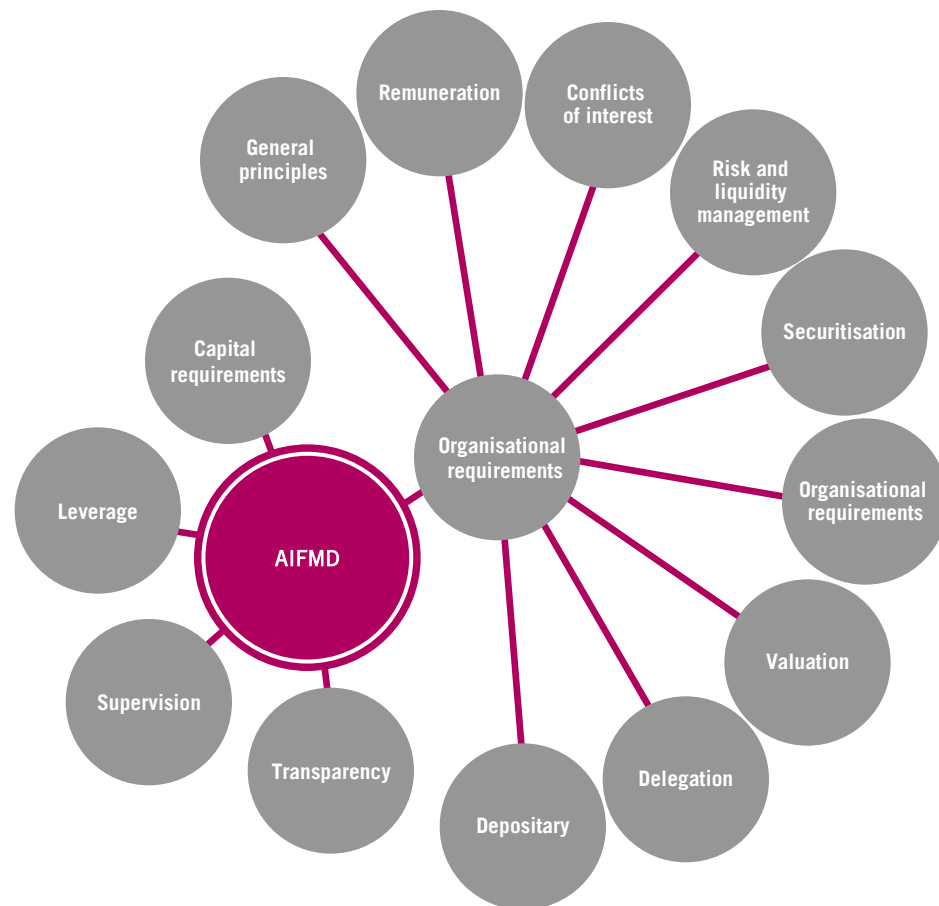
* subject to ESMA's prior analysis and approval

** established in a member state other than the member state of reference of the AIFM

AIFM Directive's provisions.

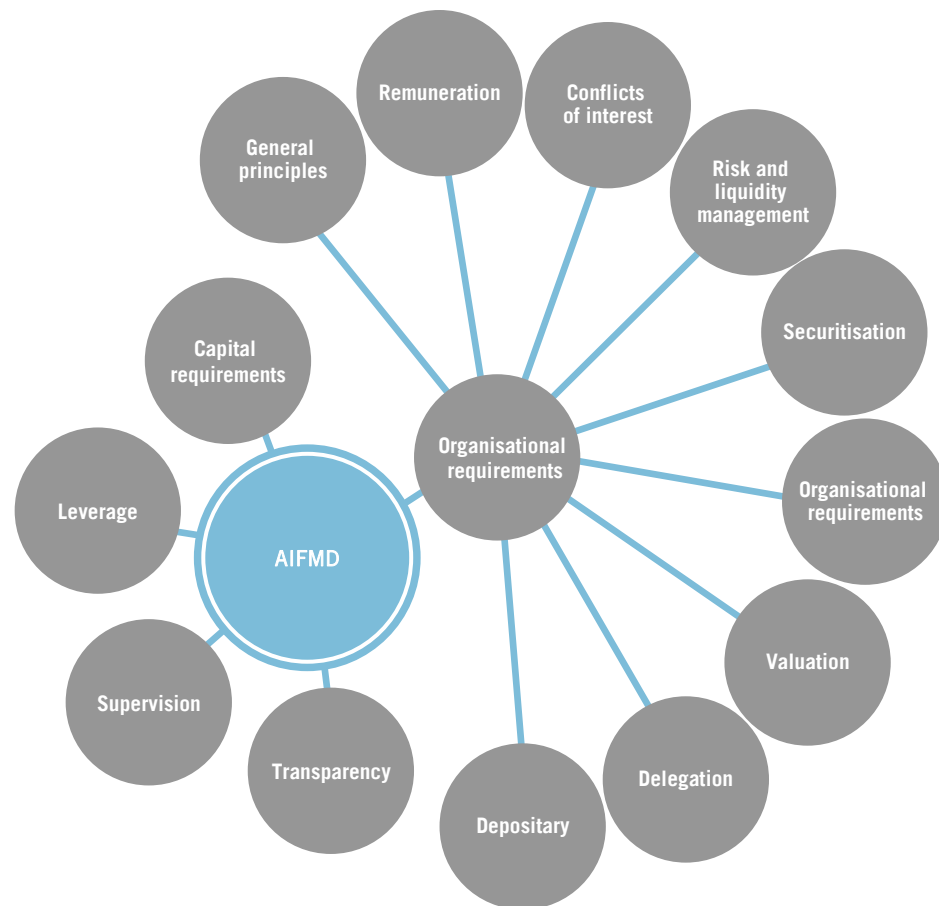
Touching points - Level 1.

This diagram represents the whole variety of subjects addressed by **Level 1** of AIFMD, i.e. the **Directive**.



Touching points - Level 2.

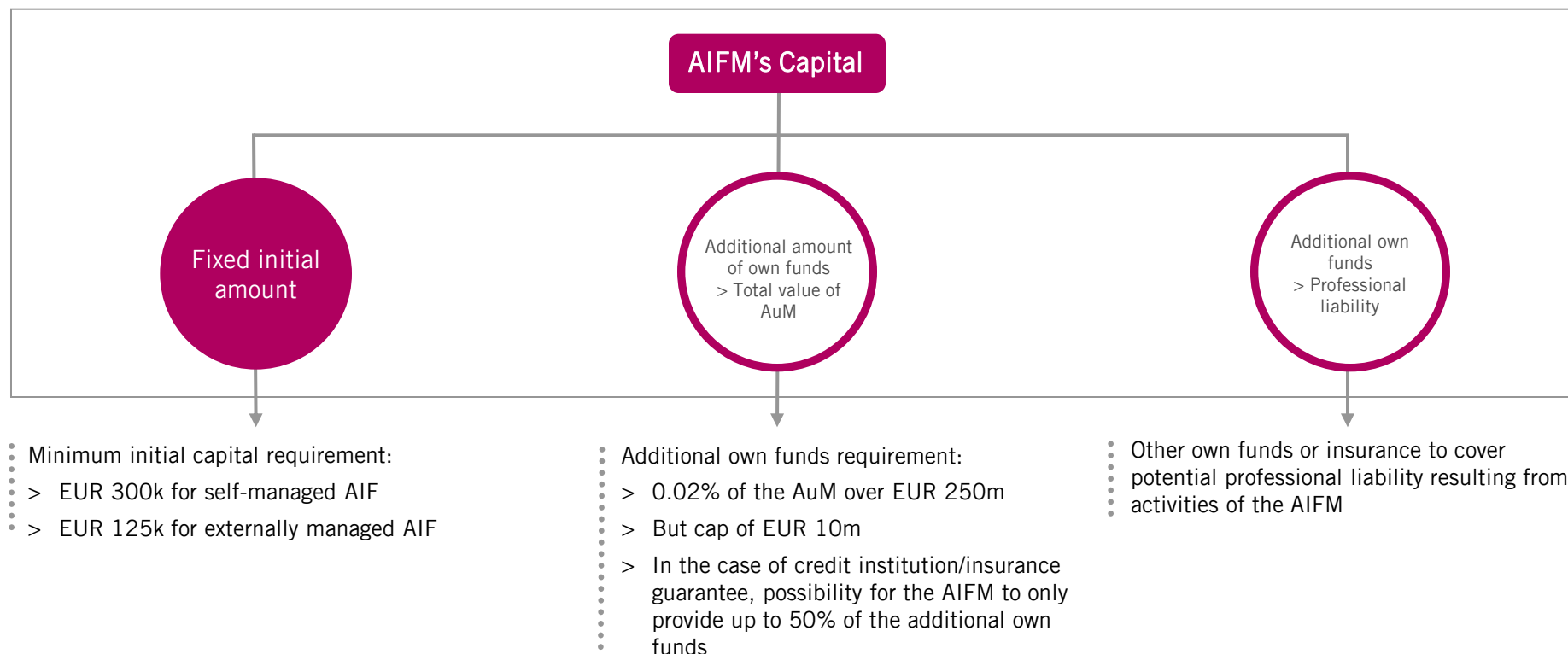
This diagram represents the whole variety of subjects addressed by **Level 2** of AIFMD, i.e. the **Regulation** and **ESMA Guidelines**.



Capital requirements.

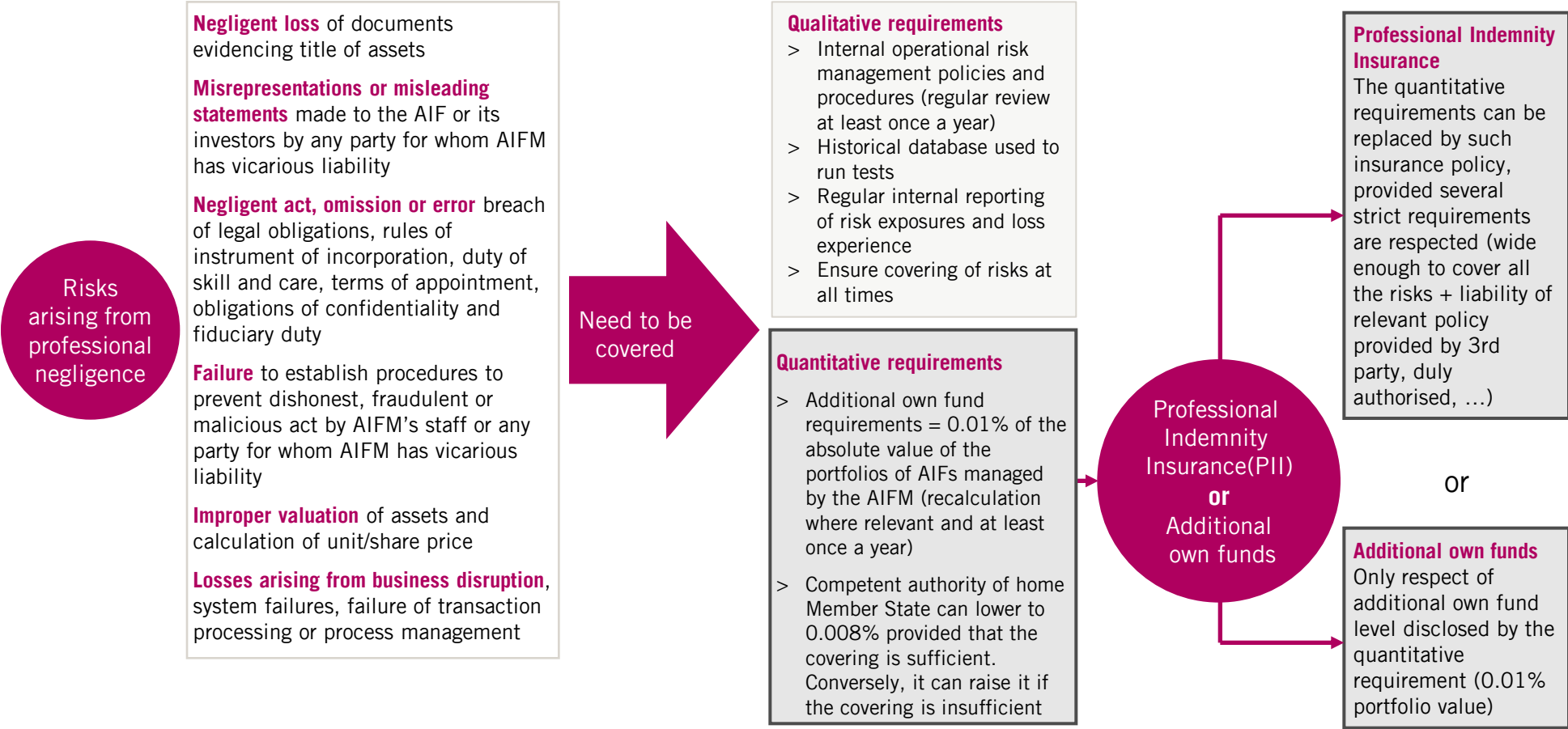


Capital requirements - Level 1.





Capital requirements - Level 2: Additional own funds covering PII.



Operating conditions.

General principles.

General principles - Level 1.



AIFMs shall:

- > act honestly, with due skill and diligence and fairly in conducting their activities
- > act in the best interests of the AIFs, the investors and the integrity of the market
- > have and employ effectively the resources and procedures that are necessary for the proper performance of their business activities
- > take all reasonable steps to avoid conflicts of interest
- > comply with all regulatory requirements applicable to the conduct of their business
- > act in AIFs best interests and treat all investors fairly

Specific requirements for discretionary portfolio management service

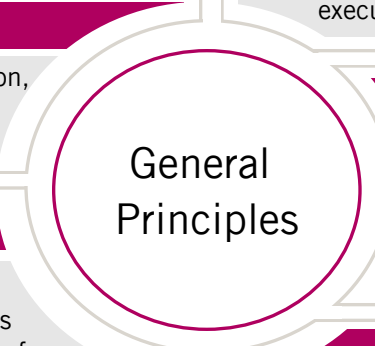
General principles - Level 1.



- > Remuneration policy to avoid inappropriate risk taking
- > Management of conflicts of interest (if not possible, disclosure of conflicts to investors)
- > Separation of risk management and portfolio management functions
- > Risk and liquidity management
- > Limits on investment in securitisation positions



General principles - Level 2.



Best interests: AIF, investors and integrity of the market

- > Appropriate policies and procedures to prevent malpractices that are expected to affect the stability and integrity of the market (ex: market timing, late trading,...)
- > Prevent undue costs being charged to AIFs and investors (excessive trading costs,...)

Execution of decisions on behalf of the AIF

- > The AIFM shall act in the best interests of the AIFs or the investors
- > AIFM shall take the following into consideration to achieve the best possible result: price, costs, speed, likelihood of execution and settlement, size, nature (relative importance)
- > Implementation of a written execution policy
- > Monitor and review (at least once a year) arrangement and execution policy

Inducements

Strict limitation of the payment or reception of fee or commission, or non-monetary benefit, to specific cases (disclosure duty of the AIFM)

Due diligence requirement

High standard of due diligence requirement in relation to investments by the AIF
Written policies and precise requirements (business plan, pre-trade, compliance with investment policies,...)

Handling of orders

- AIFM shall:
- > establish, implement and apply procedures and arrangements which provide for the prompt, fair and expeditious execution of orders on behalf of the AIF
 - > ensure that the financial instruments, sums of money or other assets are promptly and correctly delivered to (or registered in the account of) the relevant AIF

This requirement does not concern investment in assets made after extensive negotiation on the term of the agreement (e.g. investment in real estate, partnership interest or non-listed companies) because no "order" is executed → specific due diligence requirements

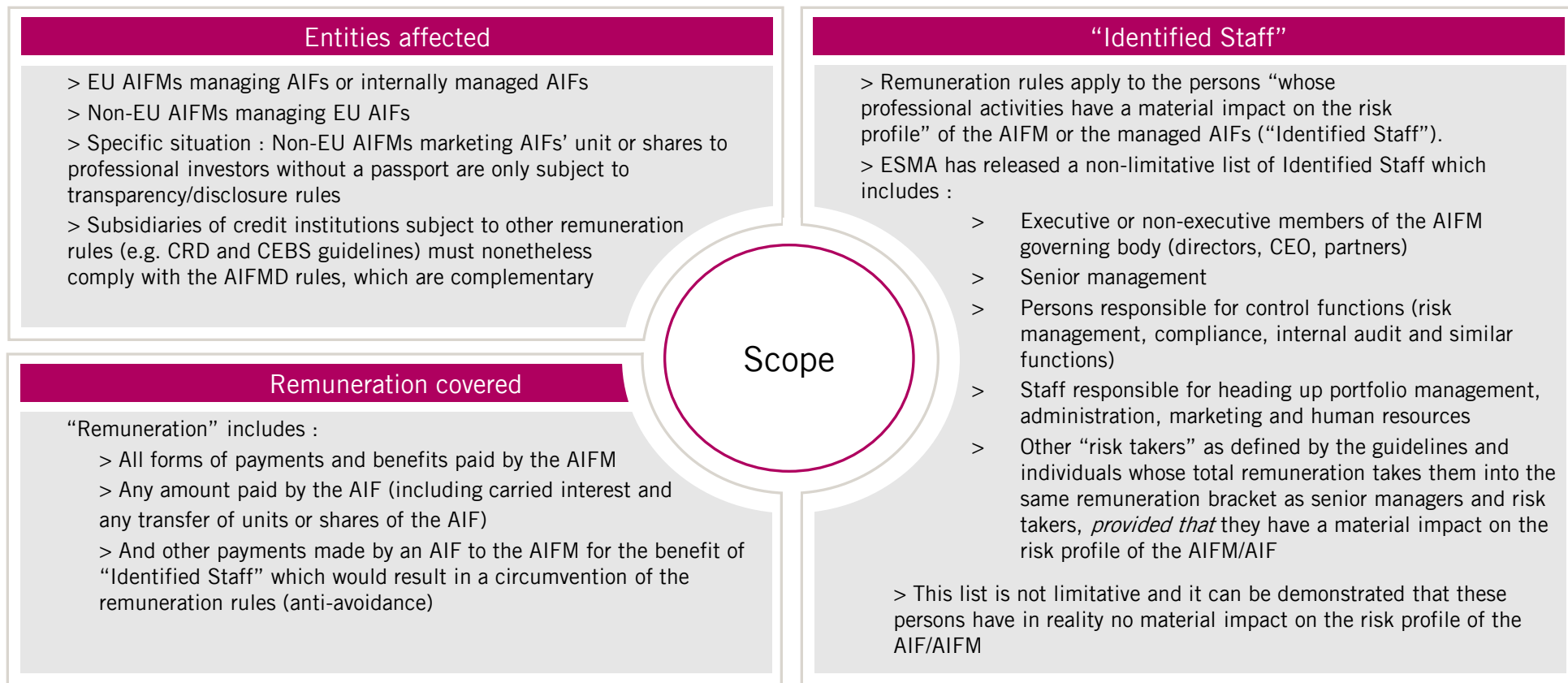
Fair treatment

Fair treatment by an AIFM includes that no investor may obtain a preferential treatment that may result in an overall material disadvantage to other investors

Remuneration.

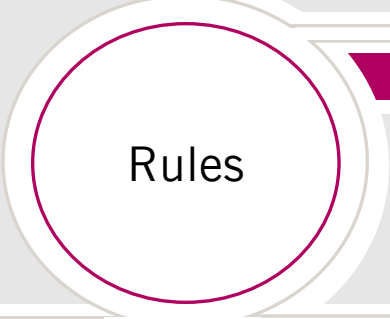


Remuneration – ESMA guidelines.





Remuneration – Level 1 and ESMA guidelines.



Remuneration rules – Key aspects

The key aspects of remuneration rules are *inter alia* the following:

- > Fixed and variable components of total remuneration must be appropriately balanced and the remuneration policy must comply with the provisions of Annex II of the AIFM Directive in a view to promote sound and effective risk management and not to encourage excessive risk taking
- > The remuneration policy must be “fully flexible” i.e. the variable part of the remuneration is likely to be reduced in case of bad performance (as far as to pay no variable remuneration at all)
- > The award process must be documented and take into account several factors such as risk and performance, life cycle and redemption policy of the AIF, individual performance, performance of the AIFM and of the AIFM’s business line
- > Variable remuneration shall be partly deferred and partially consist of units of AIFs or equivalent, and must awarded at the end or during an accrual period of at least one year
- > Quantitative and qualitative criterias must be used to assess individual performance

Delegation

- > When delegating portfolio management or risk management activities, the AIFM should ensure that :
 - > The delegates are subject to regulatory requirements on remuneration that are equally as effective as those under the ESMA guidelines, *or*
 - > Appropriate contractual arrangements are put in place to ensure that there is no circumvention of the requirements

Disclosure

- > The AIFMD requires AIFMs to disclose to the public a certain number of details concerning remuneration policy
- > According to ESMA, this disclosure does not however necessarily need to be public
- > Remuneration policies should also be disclosed internally

Proportionality

- > Remuneration requirements must be implemented on the basis of proportionality, taking into account the different types of AIFMs and categories of “Identified Staff”.
- > ESMA considers that some of the remuneration requirements may be disapplied when applying a proportionate approach

Supervisory function & remuneration committee

- > A supervisory function shall review the policy at least annually
- > A remuneration committee must be put in place for AIFMs which are significant taking into account their size (and the size of the AIFs they manage), their internal organisation and the nature, scope and complexity of their activities

Conflicts of interest.



Conflicts of interest - Level 2.



Types of conflicts of interest: Five points test

Relevant person or a person directly or indirectly linked by way of control to the AIF:

- 1) Financial gain/avoid financial loss at the expense of the AIF/investors
- 2) Interest in the outcome of a service/transaction involving the AIF
- 3) Financial/other incentive to favour: other interests than those of the AIF, investor over another investor (a group of investors) in the same AIF
- 4) Same activity carried out for the AIF and another AIF/UCITS/Client
- 5) Inducement in relation to portfolio management activities (monies, goods, services other than standard commission or fee) received from a person other than the AIF or its investors

Record keeping

- > Regularly updated records of conflicts of interest situations
- > Written reports to senior management (at least annually)
- > Disclosure to investors by durable medium or website

Conflicts of interest policy

- > Effective, in writing and proportionate
- > Must include: activities which (could) constitute a conflict of interest and procedures to prevent, manage, monitor such conflicts

Strategies for the exercise of voting rights

- > Adequate and effective strategies for determining when and how voting rights are to be exercised to the exclusive benefit of the AIF and its investors
- > Measures and procedures for monitoring and ensuring the exercise of the rights and preventing/managing the potential conflicts of interest
- > Summary description of the strategies available to investors on request

Risk and liquidity management.



Risk and liquidity management - Level 2.



Permanent risk management function

- Permanent risk management function appointed by AIFM that shall:
- > implement effective RM policies and procedures
 - > ensure and monitor compliance with risk limits
 - > provide regular updates to:
 - > government bodies regarding consistency and compliance with risk limits
 - > senior management regarding current level of risk

The RM function must be **functionally and hierarchically independent** from the operating units + safeguards against conflicts of interest

Proportionality principle applies

Risk management policy

- Risk management policy established by AIFM that shall:
- > identify all the relevant risks
 - > enable the AIFM to assess the exposure of AIF to market, liquidity, counterparty and any other relevant risks (including operational)
 - > address the elements indicated in the regulation
 - > be monitored, assessed and periodically reviewed by AIFM
 - > (any material changes shall be notified to competent authority)

Proportionality principle applies to the RM policy

Risk limits

Definition and implementation by the AIFM of quantitative and/or qualitative risk limits, addressing:

- > Market risks
- > Credit risks
- > Counterparty risks and
- > Operational risks

→ Adaptation to each AIF

Measurement and management of risk

- > Implementation of policy and procedure to identify, monitor and manage risk at any time
- > Ensure compliance with risk limits

Proportionality principle applies

Stress tests and back tests to assess the adequacy of RM policies and procedures → Corrective actions if needed

Risk and liquidity management - Level 2.



Liquidity management policies and procedures

For each AIF that is not an unleveraged closed-ended AIF, establishment of liquidity management policies and procedures in order to:

- > monitor and manage liquidity risk
- > ensure the compliance with underlying obligation to investors, counterparties, creditors and other counterparties

Alignment with investment strategy, liquidity profile and redemption policy in accordance with

- > fair treatment of all investors
- > redemption policy and its obligation

Stress tests

Under normal and exceptional liquidity conditions
Specific situations to be simulated (shortage of liquidity, atypical redemption request)

Proportionality in the frequency of such tests

AIFM shall act in the best interests of the investor in relation to the outcomes of any stress test

Measurement and management of liquidity

Appropriate liquidity measurement arrangements
procedures to assess qualitative and quantitative
of positions/intended investments

Compare with liquidity management of the AIFMs that manage other
collective investment undertakings in which the AIF invests

Consider and put into effect the tools and arrangements necessary to manage
the liquidity risk of each AIF (except for leveraged closed-ended fund)

3 Liquidity management

Liquidity limits

Implementation of adequate limits for liquidity of each AIF

Proportionality to nature, scale and complexity + consistency
with redemption policy

Determination of a course of action in case of excess

Securitisation.

Securitisation - Level 2.



Requirements for:

- > Retained interest
- > Sponsors and originators
- > AIFMs exposed to securitisations

- > Corrective action
- > Grandfathering clause

Organisational requirements.

Organisational requirements - Level 1.



AIFM shall, at all times, use **adequate and appropriate human/technical resources necessary for the proper management of AIF**

AIFM must have:

- > sound administrative and accounting procedures
- > control arrangements for electronic data processing
- > adequate internal control mechanisms (e.g. rules for employee personal transactions)
- > the capacity to safeguard and reconstruct each transaction involving the AIF
- > control arrangements to ensure that AIF's assets are invested in line with its constitutive documents

Organisational requirements - Level 2.



General requirements:

- > Decision-making procedures and organisational structure
- > Internal control mechanisms to secure compliance
- > Internal reporting and communication of information (at all levels of AIFM) and effective information flows with any third party involved
- > Maintain adequate and orderly records of their business
- > Security, integrity and confidentiality of information safeguarding procedures
- > Business continuity policy (in case of interruption of systems and procedures)
- > Accounting policies and procedures
- > Monitoring and evaluation of the systems

Proportionality of the procedures and policies with nature, scale and complexity of the business

Organisational requirements - Level 2.



Resources:

- > Sufficient personnel with skill, knowledge and expertise necessary
- > Multiple functions performed by a single person, to be discharged with equal sound, honesty and professionalism
- > Consideration for nature, scale and complexity of business when assessing the resources necessary

Electronic data processing:

- > Suitable electronic system for timely and proper recording (portfolio transaction/subscription or redemption order)
- > High standard of security

Accounting procedures:

- > Accounting procedure and policies → investor protection and accurate calculation of NAV
- > Separated accounts for each compartment of an AIF

→ These provisions are in line with Articles 5, 7 and 8 of UCITS Level 2

Organisational requirements - Level 2.



Control by senior management and supervisory function:

- > Governing body and senior management/supervisory function responsible for AIFM's compliance with AIFMD obligations
- > AIFM shall ensure that senior management is responsible for:
 - > approval/oversight/review and implementation of the general investment policy, risk management policy, adequacy of internal procedures for investment decision
 - > valuation policies
 - > ensuring presence/application of permanent compliance function, investment strategies, risk limits and remuneration policy
 - > assessing/reviewing policies
- > Senior management/supervisory staff shall receive reports on matters of compliance, internal audit, risk management, implementation of investment strategy
 - > take appropriate measures to address deficiencies
- > When AIF = contractual form (FCP), i.e. no legal personality, senior management approves the investment strategy of each managed AIF
- > When AIF = statute form (SICAV), i.e. legal personality senior management oversees the investment strategy of each managed AIF

Organisational requirements - Level 2.



Permanent compliance function:

- > Adequate policies and procedures to detect any risk of failure by AIFM and minimise such risk
- > Establishment of a permanent and effective compliance function:
 - > Appointment of a compliance officer, which must be independent of activity, with non-influencing remuneration
 - > Necessary authority, resource, expertise, access to information
- > No obligation to establish an independent compliance unit if disproportionate, document the reasons

→ This provision is in line with Article 10 of UCITS Level 2, and Article 6 of MiFID Level 2

Organisational requirements - Level 2.



Internal audit function:

- > When **appropriate and proportionate**, independent internal audit function to control audit and evaluate systems and arrangements

Personal transactions:

- > Adequate arrangement to prevent activities implying personal transaction (misuse/disclosure of confidential information, conflict with AIFM obligation, etc.)
- > Record personal transaction and immediate information of AIFM, also when delegation
- > Not only personal transaction with financial instruments but also with other assets

→ These provisions are in line with Articles 11 and 13 of UCITS Level 2, and Article 8 of MiFID Level 2



Organisational requirements - Level 2.

Recording of portfolio transaction:

- > Immediate, for each portfolio, following precise information requirements (asset, quantity, price, ...)

Recording of subscription and redemption orders:

- > Without undue delay, following precise information requirements (relevant AIF, date and time,...)

Record-keeping requirements:

- > Minimum 5-year period (unless national law prescribes more)
- > Accessibility to other AIFM (in case of transfer), competent authority

Complaints handling:

No requirements

- These provisions are in line with UCITS Level 2 and MiFID Level 2

Valuation.

Valuation - Level 1.



- > Appointment of independent valuer of assets and NAV
- > Valuation to be carried out at least once a year
- > Valuation periodicity to be adapted depending on types of assets and frequency of issuance and redemption of units
- > External or internal valuer must be independent from portfolio management and the remuneration policy
- > External valuer subject to mandatory professional registration and sufficient professional guarantees, and appointment subject to delegation provisions



Valuation - Level 2.

Valuer

External valuer

Professional guarantees:

- > Written documents signed by the valuer or its representatives
- > Should contain evidence of the external valuer's qualification and ability, notably:
 - (i) Sufficient personnel and technical resources
 - (ii) Adequate procedures
 - (iii) Adequate knowledge and understanding

Process of exchange of information

Internal valuer

Safeguards for functionally independent performance of valuation tasks

Policies, procedures & models

Format and substance for policies & procedures

- > Written policies & procedures → sound, transparent and appropriately documented valuation process
- > Reference to the valuation methodologies for each type of asset
- > Obligation, role and duties of all parties involved in valuation

Models used to value assets

- > Reasons to use a model, type, underlying data and assumption shall be explained in the policies and procedures
- > Models to be validated by senior management and by a person with sufficient expertise who has not been involved in the process of building that model.
- > Competent authority may require that the model be verified by an external valuer or an auditor

Reviews

- Appropriateness of procedures, policies and valuation methodologies to be reviewed at least once a year + before new investment strategy/new asset not covered by current strategy

Calculation

NAV calculation

- > Each time there is (i) issue, (ii) subscription, (iii) redemption, (iv) cancellation of units/share
- > At least once a year
- > Remedial procedures in case of incorrect calculation
- > Number of units or shares in issue is subject to regular verification, at least as often as the unit or share price is calculated

Consistent application if valuation methodologies

- > Over time
- > To all assets taking into account the investment strategies and the types of asset

Review of valuation by AIFM

- > AIFM must be able to demonstrate that AIFs are properly valued
- > Checks to be run (review process described in the procedures and policies) if material risk of inappropriate valuation arises
- Non-exhaustive list of control

Delegation.



Delegation - Level 1.

AIFM can delegate the performance of some of their functions* to third parties

- > Subject to the following conditions:
 - > Objective reasons
 - > Conditions regarding the delegate (sufficient resources and experience and good repute)
 - > Effective supervision by the AIFM
 - > Selection and monitoring of the delegate

Portfolio or risk management can not be delegated to

- > Undertakings that are not authorised or registered for the purpose of asset management and subject to supervision (except derogation by AIFM regulator)
- > Depositary
- > Entities whose interests may conflict with the AIFM or the investors of the AIF (derogation is possible)

* as listed in Annex 1



Delegation - Level 2: General provisions.

General principles

- 1) Delegation must not alter the responsibility of the AIFM
- 2) Obligations of AIFM towards AIF/investors shall not be altered
- 3) AIFM's respect of the conditions to be authorised under AIFMD shall not be undermined
- 4) AIFM shall ensure that the delegate carries the function effectively and in accordance with laws and regulatory requirements
 - Determination of review methods
 - Take appropriate actions in functions carried wrongfully
- 5) AIFM should retain necessary expertise and resources to be able to supervise and manage risks associated with delegation
AIFM should also check that the delegate does the same with sub-delegate
- 6) AIFM shall ensure the continuity and quality of delegated tasks
- 7) A written agreement shall define clearly the rights and obligations of the AIFM and the delegate
- 8) If portfolio management delegated, it shall be in accordance with the investment policy of the AIFM

AIFM must ensure that the delegate:

- > Disclose any development that may have a material impact on its ability to carry out the delegated functions
- > Protect confidential information
- > Establish a contingency plan for disaster recovery and test periodic backup facilities

1 General provisions

Objective reasons to delegate

To be authorised to delegate, AIFM shall demonstrate objective reasons that justify the delegation structure

→ More efficient conduct of AIFM's management of AIF

Objective reasons for delegation include (but are not limited to):

- > Optimising of business functions and processes
- > Cost saving
 - > Expertise of the delegate in administration/specific market/investment
 - > Access of the delegate to global trading facilities

The rule of "justification" with objective reasons is based on the UCITS approach

Resources, experience & good repute

AIFM has to evaluate whether the delegate has sufficient resources to perform the task and whether the persons conducting the task in the delegate entity have sufficient experience and good repute

Factors to be considered:

- 1) Substance: AIFM shall check the adequacy of the resource (sufficient personnel with skills, knowledge and experience)
- 2) Knowledge: AIFM shall check whether the persons have appropriate theoretical knowledge and practical experience
- 3) Good repute: AIFM shall check the records of the persons
Negative records include relevant criminal offences, judicial proceedings and administrative sanctions.
N.B: factor 3) *de facto* satisfied if delegate is regulated in EU, unless evidence to the contrary



Delegation - Level 2. Entities issues.

Conflicts of interest

Non-exhaustive criteria to assess whether a delegation would result in a conflicts of interest situation:

- > AIFM and delegate are members of the same group or have any other contractual relationship
- > Delegate and investors are members of the same group or have any other contractual relationship
- > Likelihood of financial gain of delegate at the expense of the AIFM or investors
- > Likelihood of interest of the delegate in the outcome of service or activity provided to AIFM or AIF
- > Likelihood that delegate receives inducements from third person

Functional and hierarchical independence of risk or portfolio management function:

- > Avoidance of combination of portfolio management tasks and operating task
- > Avoidance of combination of RM tasks with operating tasks or supervision of them
- > Separation is ensured in the whole hierarchical structure of the delegate

Criteria to assess whether conflicts are properly identified, managed, monitored and disclosed to the investors:

- > AIFM ensures that the delegate takes all reasonable steps/has procedures in place to identify, manage and monitor potential conflicts of interest situations
- > Disclosure of potential conflicts of interest to the AIFM

Delegation of portfolio or risk management

The following entities should be considered as authorised for the purpose of asset management and subject to supervision:

- > Management companies authorised under the UCITS Directive
- > Investment firms authorised under MiFID to perform portfolio management
 - > Credit institutions authorised under Directive 2006/48/EC having the authorisation to perform portfolio management under MiFID; and
 - > Externally appointed AIFM authorised under AIFMD
 - > Specific rules apply when:
 - > delegation to undertakings which do not fulfill the above criteria
 - > delegation to third-country entities

2 Entities issues

Letter-box entity

AIFM is deemed a letter-box entity and is no longer considered to be AIFM when:

- 1) AIFM no longer retains necessary resource and expertise to supervise the delegation and manage the risk associated with it
- 2) AIFM no longer has the power:
 - (i) to take decisions in key areas under the responsibility of senior management
 - (ii) to perform senior management function (implementation of investment policy, investment strategy, ...)
- 3) AIFM loses the right to inquire, inspect, have access or give instructions or this becomes impossible in practice
- 4) The delegated tasks substantially exceed the remaining (qualitative and quantitative approach: types and importance of the assets managed under delegation, geographical and sectoral spread of the investments, risk profile of the AIF, type of investment strategies, types of tasks delegated, configuration of delegates and their subdelegates)



Delegation - Level 2. Operational issues.

Delegation to third-country undertakings

Specific rules related to delegation to third-country undertakings where the delegation of portfolio or risk management is concerned

Written agreement between authorities of the countries of the AIFM and of the delegate

- > The agreement should provide the following rights to home MS authority:
 - (i) Access to relevant information/documents
 - (ii) Request on-site inspection
 - (iii) Receive immediate information from third country authority in case of breach
 - (iv) Cooperate in enforcement powers in case of breach of the AIFM directive

Consent of sub-delegation

Condition displayed for the delegation shall apply mutatis mutandis where the delegate sub-delegates any of its functions

The AIFM shall demonstrate its approval for the sub-delegation in writing

A general consent in advance by the AIFM shall not be deemed consent

3 Operational issues

Effective supervision

Situations in which delegation deemed to prevent the effective supervision of the AIFM:

- > AIFM, auditors or authorities do not have access to data related to the delegated functions or the business premises of the delegate
- > Delegate does not cooperate with competent authorities of the AIFM
- > All information necessary to supervise the delegated functions are not made available

Notification of sub-delegation

Notification shall contain:

- > Details on the delegate and the sub-delegate
 - > Name of the competent authority (in the case the sub-delegate is authorised or registered)
- > Delegated tasks
- > AIF affected by the sub-delegation
- > Copy of written consent by the AIFM
- > Intended effective date of the delegation

Depositary.

Depositary - Level 1.



An AIFM must appoint a single depositary in respect of each AIF it manages

Depositary role

- > Monitor the reception of all investors' subscriptions and hold in custody all financial instruments of the AIF
- > Ensure that AIF's **cash flows** are properly monitored, in particular booking of subscription monies on appropriate cash accounts
- > Safekeep the assets (can be delegated under specific conditions):
 - > custody of **financial instruments** that can be physically delivered or registered in a financial instruments account (segregation being required)
 - > verification of ownership of all **other assets** on basis of information provided by the AIF or the AIFM and where available – external evidence
- > Oversight functions

Depositary entities

- > The depositary must be a credit institution or an investment firm both having their registered offices in the EU, or any other entity subject to prudential regulation and ongoing supervision which falls within the categories of institution determined by Member States to be eligible to be a depositary under article 23(3) of UCITS Directive

Location of depositary

- > EU AIF: in the home member state of the AIF
- > Non-EU AIF: in the third country where the AIF is established, in the home member state of the AIFM or in the member state of reference of the AIFM



Depositary - Level 1.

Depositary liability:

- > A strict (no fault) liability for losses of financial instruments held in custody

Obligation to return, without undue delay, identical financial instruments or the corresponding amount to the AIF (or the AIFM)

Exception: no liability if depositary can prove that the loss has arisen as a result of an external event beyond its reasonable control the consequences of which would have been unavoidable

- > A fault-based liability for all other losses caused by the depositary's negligent or intentional failure to comply with its obligations under the AIFMD

Possible contracting out of liability where the custody of financial assets is delegated to a sub-depositary if:

- > requirements for the delegation are met
- > two written contracts:
 - > between depositary/sub-depositary expressly transferring liability
 - > between the depositary/the AIF (or the AIFM) explicitly authorising discharge for objective reasons



Depositary - Level 2: Appointment.

The agreement between the AIFM and the depositary

Alignment with the particulars required in the depositary contract with the UCITS Directive

Regulation provides a list of 18 elements to be included in the agreement signed between the AIFM and the depositary, and several precisions to be brought

There is the possibility to enter a framework agreement in order to avoid the obligation for specific written agreement for each AIF

The depositary regimes of UCITS and AIFMD are different! Several elements were added to the existing UCITS requirements (eligible assets, right of re-use, cash accounts, escalation procedure) and other were amended (termination of contract, liability, flow of information)

Difference in liability regime is consequent: for UCITS, a simple recall of the fact that the depositary's liability is not altered by delegation is sufficient. For AIFM, Regulation requires the parties to detail conditions in which a transfer can occur

1

Appointment

Third country depositary

Depositary of non-EU AIF must comply with the conditions laid down in article 21.6 of the Directive

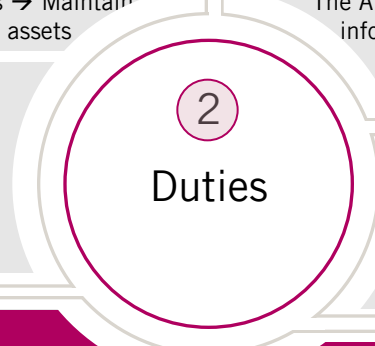
Regulation provides for a list of criteria to assess that the regulation and supervision applicable to a depositary in a third country are effective and comparable to those applicable to EU credit institutions or investment firms:

- > Independence of authority
- > Eligibility criteria for depositary function
- > Capital requirements
- > Operating conditions
- > Requirements on performance
- > Sufficiently dissuasive enforcement actions

The equivalence to EU requirements is a very hard condition that may not be fulfilled by some host member states of AIFs



Depository - Level 2: Duties.



Safekeeping

Definition of financial instruments to be held in custody:

Financial instruments which are:

- > able to be physically delivered to the depository
- > not able to be physically delivered to the depository which meet the following conditions:
 - > transferable securities
 - > capable of being registered or held in an account in the name of the depository)

Minimum safekeeping duties:

- > Ensure proper booking
- > Maintain records and segregated accounts
- > Conduct reconciliation (regularly)
- > Due care (high level of investor protection)
- > Assess/monitor all custody risks
- > Introduce organisational arrangements to minimise the risk of loss
- > Verify ownership rights

Definition of "Other assets"

- > A contrario approach
- Minimum safekeeping duties:**
 - > ownership verification → Ensure timely access to relevant information, possess sufficient and reliable information
 - > record keeping duties → Maintain record-keeping of the assets

Prime Broker (PB)

AIFM must ensure the PB provides depository with a report concerning notably the total value of assets held by the PB for the AIF

Oversight duties

The depository should:

- > assess the risks associated with the nature, scale and complexity of an AIF and set up appropriate procedures
- > perform ex post verifications of procedures which are under the responsibility of the AIF, the AIFM or a third party
- > establish escalation procedure

The AIFM must ensure that the depository disposes of all relevant information necessary to exercise its duties

Clarification on specific duties is further detailed in the Regulation

Due diligence duties

Regulation details the methodology to be followed to ensure an appropriate due diligence for the selection and on going monitoring of the delegate

Cash monitoring

The depository's obligations consist in verifying that there are procedures in place to appropriately monitor the AIF's cash flows (periodical review at least once a year)

This includes to ensure the following:

- > All cash is properly booked
- > There are proper reconciliation procedures
- > Appropriate cash flows identification procedures are implemented
- > Monitoring and consistency check
- > Remedial action is taken whenever a discrepancy is identified
- > The depository is provided with relevant information related to a cash account opened with a third party

Segregation obligation

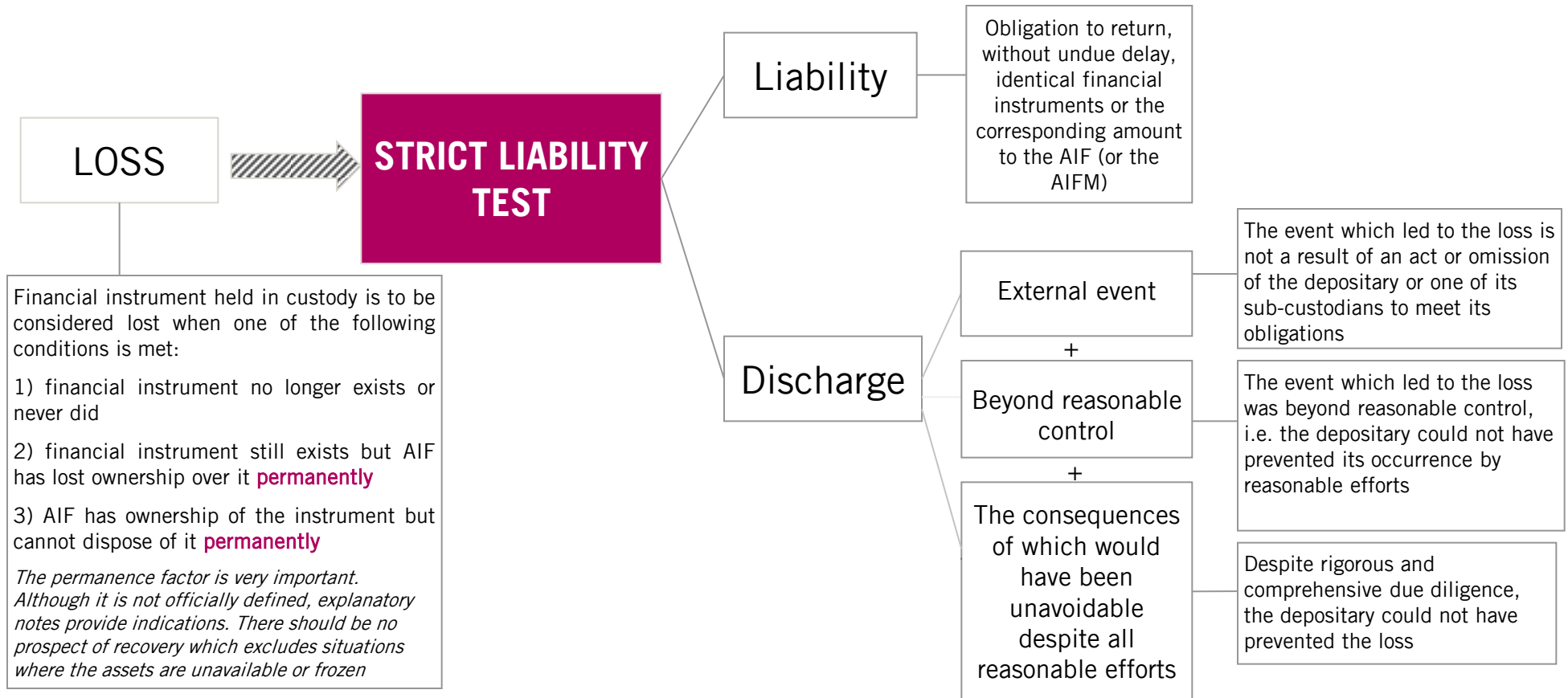
Where safekeeping functions have been delegated to a third party, the depository must check that this third party segregates the assets belonging to the AIF's depository's clients from its own assets and from assets of the depository

Regulation provides with the methodology to perform this check

The segregation is supposed to mitigate the consequences of the insolvency of the sub-custodian



Depositary - Level 2: Liability for financial instrument held in custody.



Transparency.



Annual report - Level 1.

Frequency:

- > Annual report of EU managed/marketed AIFs to be made available by AIFM to investors (on request) and competent regulator within 6 months following the end of the financial year
- > Exception: annual report to be made public within 4 months following the end of the financial year if AIF is required to make it public

Content:

- > Balance sheet
- > Income and expenditure account
- > Report on the activities of the financial year
- > Any material change in the information given to investors
- > Total amount of remuneration of AIFM staff members
- > Balance sheet to be prepared in accordance with the accounting standards of the country of the AIF
- > Aggregate amount of remuneration broken down by senior management and members of staff whose actions have a material impact on the risk profile of the AIF





Annual report - Level 2.

Objective definition of content and format requirements for:

- > Primary financial statements (balance sheet, income and expenditure account)
- > Report on the activities of the financial year
- > Definition of material changes:
 - Any changes in information “[...] if there is a substantial likelihood that a reasonable investor, becoming aware of such information, would reconsider its investment in the AIF, including for reasons that such information could impact an investor’s ability to exercise its rights in relation to its investments, or otherwise prejudice the interest of one or more investors of the AIF”
- > Remuneration disclosure: 3 options
 - > Total remuneration of the entire staff of the AIFM
 - > Total remuneration of those staff of the AIFM who in part or in full are involved in the activities of the AIF
 - > Proportion of the total remuneration of staff of the AIFM attributable to the AIF

Disclosure to investors - Level 1.



Information to be disclosed by the AIFM to investors before they invest (and in case of material changes):

- > Description of investment strategy, investment policy and objectives of the AIF and procedures to change them
- > Description of the main legal implications of the contractual relationship entered into for the purpose of investment
- > Identity of AIFM, AIF's depositary, auditor and any other service providers as well as their duties and investors' rights
- > Description of:
 - > any delegation of management functions
 - > the covering of professional liability risks
 - > AIF's valuation procedure
 - > AIF's liquidity risk management
 - > all fees, charges and expenses
 - > how the AIFM ensures a fair treatment of investors and preferential treatments
- > Latest annual report
- > Procedure and conditions of issue and sales of units / shares
- > Latest NAV of AIF and historical performance of AIF
- > Identity of the prime broker
- > Investors must be informed by the AIFM of **any arrangement made by the depositary** to contractually discharge itself from liability
- > **Certain specific information** is to be disclosed by the AIFM to investors on a periodic basis (e.g. risk profile of the AIF) or on a regular basis (e.g. for AIFs employing leverage)

Disclosure to investors - Level 2.



Periodic disclosure to investors

- > Percentage of assets subject to special arrangements
- > New arrangements for managing the liquidity of the AIF
- > Risk profile of the AIF
- > Risk management systems employed by the AIFM

- > Information to be disclosed as part of the periodic report to the investors, as required by the AIF rules or offering documents, or at least once a year

Regular disclosure to investors → whenever a material change occurs

- > Maximum level of leverage
- > Right of re-use of the collateral
- > Nature of guarantee granted

Reporting to competent authority – Level 1.



No restrictions on AIF's investment policy. AIFM is required to report on:

- > principal markets and instruments in which it trades on behalf of the AIF it manages
- > principal exposures and most important concentrations of each of the AIF it manages
- > risk and liquidity management arrangements
- > current risk profile of each AIF managed
- > assets in which the AIF invested
- > results of stress tests re: liquidity risk of AIF / risks associated with each investment position of AIF
- > use of leverage on a substantial basis

Reporting to competent authority – Level 2.



- > Format and content of the reporting to competent authorities
- > Use of leverage on a substantial basis
 - > Criteria to assess whether there is a use of leverage on a substantial basis:
 - > Type of AIF (including nature, scale, complexity)
 - > Investment strategy
 - > Market conditions
 - > Potentiality of market risk induced by the exposure of the AIF
 - > Potentiality of the contribution to a downward spiral of price due to the use of certain techniques
 - > Potential contribution to the build-up of systemic risk, or risk of disorderly markets through the degree of leverage employed
 - > Monitoring on on-going basis and new assessment when there is a material change

Supervision.

Supervision and cooperation between authorities - Level 1.



Cooperation arrangement between EU & Non-EU authorities

Cooperation arrangement to be in writing, and shall provide for:

- > Exchange of information for supervisory and enforcement purposes
- > Right to obtain all necessary information – Right to request an on-site inspection (to perform directly or to be performed)

Third country competent authority shall assist the EU competent authority in the enforcement of EU legislation

Member State of Reference (MSR) : in case of multiple choices

Procedure in case of multiple possibilities for MSR:

- > Request sent by the AIFM to all potential MSR
- > All potential MSR contact each other and ESMA (within 3 business days)
 - > Research of other potential MSR by those already contacted (ESMA is in charge of contacting these other potential MSR)
 - > Discussion and joint decision for determination of the appropriate MSR within 1 week (ESMA should facilitate the process)

Supervision
&
Cooperation

Cooperation and exchange of information between EU authorities

ESMA provided a pro forma reporting template to facilitate the communication between the various national authorities

Leverage/controlling stakes.

Leverage - Level 1.



- > Disclosure to investors and reporting to regulator in case of use of leverage
- > Leverage limits set up by the AIFM to be disclosed to investors
- > Leverage limits to be set up by the regulator of the AIFM if such use contributed to the build-up of systemic risk



Leverage - Level 2: Limits.



The competent authorities have been given the right to limit the level of leverage used by an AIFM, after having performed the following assessment:

- > Assessment of the risk entailed by the use of leverage with regard to information provided under articles 7 (3) (application for authorisation), 15 (4) (maximum level of leverage set by AIFM), 24 (4) and 24 (5) (reporting to competent authorities)
- > Assessment of the potential contribution to the build-up of systemic risk in the financial system

Various illustrative circumstances are given in the Regulation that need to be taken into account as a minimum

- > leverage → important source of market, liquidity, counterparty risk to a financial institution
- > leverage → contribution to downward spiral of price

Controlling stakes - Level 1.




- > Mandatory notification to competent regulator of acquisition by AIF of major holdings or control (i.e. more than 50% of voting rights) of non-listed companies (exclusion of SMEs)
- > Disclosure to the company concerned, its shareholders and regulator of the AIFM
- > Disclosure of the policy for preventing and managing conflicts of interest
- > Specific annual report requirements
- > Limitation on asset stripping for 24 months following the acquisition of control




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