



06 February 2013

Dear Sir/Madam,

**JAC response to ESMA consultation paper - Guidelines on key concepts of the AIFMD (ESMA/2012/845) (the AIFMD Key Concepts Consultation)**

This paper responds to the AIFMD Key Concepts Consultation. The Joint Associations Committee on Retail Structured Products (the **JAC**<sup>1</sup>) welcomes the opportunity to comment on the proposals in this consultation paper. We start by setting out in the General Comments section, below, our understanding of the scope of the Alternative Investment Fund Managers Directive<sup>2</sup> (the **AIFMD**) from a structured issues perspective. We then move on, in Appendix 1, to provide our response to the relevant questions in the AIFMD Key Concepts Consultation and in Appendix 2 to provide suggested drafting amendments to the draft guidelines on key concepts of the AIFMD.

The members of the JAC comprise most of the major firms (both financial institutions and law firms) involved, among other things, in the creation (and to some extent distribution) within the EU of structured issues. The JAC is therefore well positioned to comment on the specifics of structured issues and how these differ from investment funds.

The members of the JAC have done their best to respond to the relevant aspects of the AIFMD Key Concepts Consultation. However, we do wish to highlight a concern to ESMA as to the period given for the consultation process. The AIFMD Key Concepts Consultation was issued shortly before the December holiday period with responses due by 1 February 2013 – there is a real risk that such a short consultation period will mean that the proposals do not receive adequate consideration from those who are sometimes best placed to assess whether they will achieve their intended effect and whether they could create legal or regulatory uncertainty.

## **GENERAL COMMENTS**

The JAC is of the view that structured issues should not fall within the scope of the AIFMD as they fall outside the definition of AIFs. The JAC corresponded with the European Commission in 2010 in relation to the AIFMD and structured issues with a view to obtaining clarification that the AIFMD is not intended to apply to structured issues. It was hoped that such clarification would be given in the AIFMD Key Concepts Consultation or the Consultation Paper on Draft Regulatory Technical Standards on Types of AIFMs<sup>3</sup>. No such clarification has been issued however notwithstanding

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1 The JAC is sponsored by multiple associations with an interest in structured products. In the first instance, queries may be addressed to BGourisse@isda.org.

2 Directive 2011/61/EU of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

3 ESMA/2012/844

that some respondents to the discussion paper published last February<sup>4</sup> raised comments specific to structured issues<sup>5</sup>. The JAC is therefore seeking affirmation from ESMA that structured issues fall outside the scope of the AIFMD in order to ensure that there is a common understanding of the entities captured by the AIFMD and a uniform and consistent application of the AIFMD across Member States.

In the absence of such clarification we believe that the current uncertainty arising from the AIFMD could have unintended adverse effects on the market for structured issues and the funding and liquidity generated by such issues. This could have a negative impact on Europe's real economy given that liquidity has been in short supply since the financial crisis and is critical for a well-functioning market. As indicated in further detail below, structured issues are capital markets issuances, issued with a view to raising liquidity for a bank or other financial counterparty as opposed to with a view to investing such capital in accordance with a defined investment policy for the benefit of investors. Whilst the time given for responses to this consultation has not permitted market research into the potential consequences of the AIFMD applying to structured issues, we note<sup>6</sup> that recent estimates of gross sales of structured investment products and *Sukuk* indicate that these are large markets generating significant liquidity in the capital markets. We also understand that liquidity generated by the issuance of loan participation notes is sizeable.

#### Overview of structure of response to AIFMD Key Concepts Consultation

- Explanation of why structured issues are not AIFs
- Application of the securitisation special purpose entity exclusion to structured issues
- Conclusion
- Appendix 1 – Responses to relevant questions in the AIFMD Key Concepts Consultation
- Appendix 2 – Proposed drafting amendments to draft guidelines on key concepts of the AIFMD
- Appendix 3 – Participating Associations

#### Explanation of why structured issues are not AIFs

- A fundamental question to ask in relation to the scope of the AIFMD is whether or not an entity/structure is an AIF and therefore needs to appoint an AIFM. The JAC is of the view that structured issues should fall outside the scope of the AIFMD on the basis that such structures do not constitute AIFs. By **structured issues** we are referring to (1) transferable contractual securities negotiable on the capital markets which are (2) issued by a special

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4 The ESMA Discussion Paper on Key Concepts of the AIFMD and Types of AIFM published in February 2012 (the **ESMA Discussion Paper**).

5 Such comments include: (i) requests for confirmation that SPVs should not be considered as AIFs (comment number 6 on page 23); (ii) a request for confirmation as to how the SSPE exclusion might apply to structured finance instruments (SFIs) pointing out that physically backed SFIs, such as physically backed ETCs, issued by stand-alone special purpose entities have many of the features of securitisation (comment 55, page 33); (iii) a request for confirmation that *sukuk*, clearing services, special purpose acquisition companies (SPACs) and structured investment vehicles (SIVs) do not fall within the definition of collective investment undertakings and, therefore, are outside the scope of the AIFMD (comment 55, page 33); (iv) the view that the look through to underlying beneficial owners should not apply to single investor SPVs (comment 79, page 37); (v) the suggestion that raising debt from the capital markets generally should be an additional criteria for differentiating investment funds and ordinary business undertakings (on the basis that only corporate entities or SSPEs issue unsecured debt into public markets) (comment 94, page 40); (vi) the suggestion that an AIF must involve "investment management", for example, the presence of a designated investment manager, the extent to which the issuer (or any person on the issuer's behalf) has any discretion or control over the capital raised, the extent to which there is any actual investment of that capital and to the extent the issuer is tracking a strategy index, whether the index embeds some level of actual investment management (comment 97, page 40).

<sup>6</sup> See paragraph 6 (*Extent of market impact*) of the General Comments section below.

purpose vehicle as a form of intermediation between a bank or other financial counterparty and investors and (3) where there is no entity with day-to-day discretion and control over the management of the assets of the special purpose vehicle. Reasons why structured issues should not fall within the scope of the AIFMD are as follows:

**1. Structured issues are capital markets issuances and not funds**

The AIFMD is intended to apply to "AIFMs managing all types of funds that are not covered by Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to the undertakings for collective investment in transferable securities (UCITS)."<sup>7</sup> Applying a principles based interpretation of the AIFMD, structured issues are capital markets issuances and not funds. Structured issues are a form of intermediation between a bank or other financial counterparty and investors and not a means of raising capital with a view to investing such capital in accordance with a defined investment policy for the benefit of investors. The funding and liquidity generated by structured issues is significant (as indicated above) and the current uncertainty arising from the AIFMD could have unintended adverse effects on the market for structured issues and Europe's real economy.

**2 This is because structured issues are for raising capital for a bank or other financial counterparty – ie financial intermediation**

(a) Where the issuer of a structured product is an operating company (for example, a bank) whose business is not to raise capital and invest such capital in accordance with a defined investment policy for the benefit of investors, an issuance by such entity would not fall within the scope of the AIFMD as such entities are not collective investment undertakings due to their other commercial activities. Additionally, the reference to "investing...in accordance with a defined investment policy for the benefit of those investors" in the definition of AIFs indicates that investors should benefit generally from the investment of capital contributed by investors (and the management of such investment). By contrast, in the case of issuances by operating companies, the investors will benefit from the creditworthiness of the relevant issuer rather than returns on a pool of assets invested and managed in accordance with a defined investment policy for the benefit of such investors. Indeed such issuances may be purely synthetic (for example, notes or warrants issued by a bank where the return on such notes or warrants is determined by reference to the performance of an index or share) and there are no underlying assets or contracts identified in the issue for the benefit of investors.

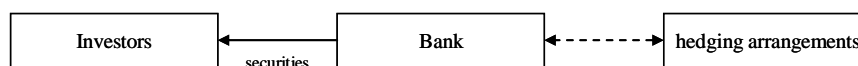
(b) Given that structured products issued by operating companies should fall outside the scope of the AIFMD, from a policy perspective a structured issue issued by a special purpose vehicle with the same payment profile as the structured product issued by an operating company should also fall outside the scope of the AIFMD. This is because from an economic perspective such products are equivalent. The inclusion of the special purpose vehicle in the structured issue represents a form of intermediation, often carried out to meet investor requirements.

(c) This can be shown in the following diagrams:

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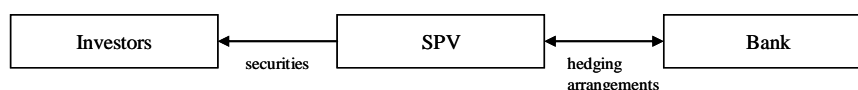
<sup>7</sup> Recital (3) of the AIFMD.

(i) *balance sheet issue by a bank or financial counterparty:*



The hedging arrangements might be a derivative contract, but the Bank is not required by the terms of the securities to enter into hedging arrangements.

(ii) *structured issue involving a special purpose vehicle (SPV):*



In this case the hedging arrangements (eg a derivatives contract) are part of the terms of the securities.

In both cases the securities have a specified payout and the derivatives contract is a means of hedging that payout. Returns are not directly linked to income or profits generated by the sale or management of the AIF's assets (i.e. capital is not raised with a view to investing it in accordance with a defined investment policy for the benefit of those investors as required by the definition of "AIFs"). As mentioned, structured issues are capital markets issuances, issued with a view to raising liquidity for a bank or other financial counterparty. The funding and liquidity generated by structured issues is significant and the current uncertainty arising from the AIFMD could have unintended adverse effects on the market for structured issues and Europe's real economy.

### 3. As a result there are very important differences between structured issues and an AIF

(a) *defined payment profile: not an investment policy:* In a structured issue capital is not raised with a view to investing it in accordance with a defined investment policy or managing pooled capital to generate a pooled return for the benefit of investors. Rather structured issues have a pre-defined payout profile (i.e. the actual return received by investors is not directly linked to any asset management of investments as in the case of an AIF). To the extent assets are acquired, these are typically acquired to provide investors with security for the issuer's obligations and not with a view to investing to generate pooled profit or income for the benefit of investors.

The purpose of a structured issue is not to buy assets and manage these for the benefit of investors. The purpose of a typical structured issue is to provide a pre-defined payment profile to investors which is then hedged by requiring specific assets, such as a holding of collateral and/or a derivative transaction.

(b) *Assets are acquired for hedging the payment profile, not as a pooled investment:* In the case of structured issues the offering document may state that issue proceeds will be used to purchase specified assets (to provide investors with security for the issuer's obligations and not with a view to investing to generate profit or income for the benefit of investors) or enter into a derivative transaction to fund payments under the securities (as opposed to for the purposes of "investment") but the factors tending to indicate the existence of a defined investment policy set out in the ESMA Consultation on Key Concepts will not be satisfied. For example, there are no investment guidelines referring to investment criteria (such as the requirement

to invest in certain categories of asset, pursue certain strategies, invest in particular geographical regions, or conform to restrictions on leverage, minimum holding periods or other restrictions designed to provide risk diversification) and no investment policy "set out in a document which becomes part of or is referenced in the rules or instruments of incorporation of the undertaking". Note that structured issues are contractual based investments, not investments issued in the legal form of equity of the issuer.

Consistent with this, the provisions of the AIFMD do not fit the context of structured issues. For example, structured issues do not have units or shares to which a net asset value can be attributed.

#### **4. Structured issues are already regulated**

The regulation of structured issues of securities is already addressed in other regulatory regimes. Structured issues are subject to the recently enhanced Prospectus Directive regime and going forward will be subject to the PRIPS regime. The bank or financial counterparty is also subject to full financial services regulation (eg for arranging, selling). Embedded derivatives contracts will be subject to EMIR and MiFIR in many cases.

#### **5. Further examples of structured issues with important market implications**

- (a) In the case of Sukuk, an important funding method for the Islamic world, in addition to the arguments above, we believe such issuances should not be AIFs as they are comparable with ordinary bond issuances. Purchasers of Sukuk are purchasing a product with a pre-defined repayment profile. The transfer or holding of assets by the issuing entity is made for the purpose of creating an Islamic compliant product and not for the purposes of investment in accordance with a defined investment policy for the benefit of investors (i.e. the actual return received by investors is not directly linked to any asset management of investments).
- (b) In the case of loan participation notes (**LPNs**), an important funding method for many capital markets issuers, in particular emerging market issuers, in addition to the arguments above, we believe such issuances should not be AIFs as they are also comparable to normal debt financing. In these issuances there is normally a note issue by a special purpose entity where the proceeds of such note issue are used to finance a deposit, loan or other borrowed money debt instrument from such special purpose entity to/with a third party entity (such deposit, loan or other borrowed money debt instrument, the Underlying Finance Instrument). Interest and principal payments on the Underlying Finance Instrument will be received by the special purpose entity and passed to investors on a pro-rata basis. The special purpose entity will typically grant investors in the loan participation notes security over certain rights in the Underlying Finance Instrument. However, the actual return received by investors is not directly linked to any asset management of investments in accordance with a defined investment policy. Such instruments are financing instruments - the prospectus typically specifying that the proceeds of issuance will be used for the sole purpose of financing the Underlying Finance Instrument<sup>8</sup>.

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<sup>8</sup> To constitute a Deliverable Obligation (as defined in ISDA's 2003 Credit Derivatives Definitions (as amended)) under a credit derivative incorporating ISDA's "Additional Provisions for LPN Reference Entities", this wording is required.

## 6. Extent of market impact

The time given for responses to this consultation has not permitted market research into the potential consequences of the AIFMD applying to structured issues. We also question whether impact studies to date have taken into account the market for structured issues.<sup>9</sup> However, we believe that if the current uncertainty arising from the AIFMD is not resolved this would adversely affect the market for structured issues. Recent estimates of gross sales of structured retail investment products have been reported to have amounted to EUR 174.2bn in Europe during the year 2010 and global Sukuk issuances have been reported to have amounted to USD 121 billion in 2011. This would have detrimental effects on investor choice and would have a significant negative impact on the real economy, including Islamic and emerging markets funding markets if *Sukuk* and loan participation notes are adversely affected.

### Application of the securitisation special purpose entity exclusion to structured issues

- The AIFMD contains a number of exclusions. From the perspective of structured issues, a key exclusion is the securitisation special purpose entities (**SSPE**) exclusion contained in Article 2(3)(g) of the AIFMD. The meaning of the term "securitisation" as used in the SSPE exclusion is defined by reference to Article 1(2) of Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions and other activities which are appropriate to accomplish that purpose (such Regulation of the European Central Bank, the **Statistics Regulation**).
- The SSPE exclusion is helpful for structured issues. Subject to the next paragraphs, many of such issues would fall within the SSPE exclusion as there will be a transfer of an asset or pool of assets and/or the credit risk of an asset or pool of assets in accordance with the SSPE exclusion and corresponding definitions in the Level 1 text.
- However, we note that the ECB has issued guidance as to the meaning of "financial vehicle corporation" and "securitisation" in Regulation ECB/2008/30 of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (such guidance, the **Statistics Regulation Guidance**).<sup>10</sup> The Statistics Regulation Guidance is described as providing "statistical support and background information" in connection with producing harmonised statistics in the context of the Statistics Regulation. We therefore see no reason why the Statistics Regulation Guidance should determine the status of particular products for purposes of the interpretation of the term "securitisation" and the SSPE exclusion in the AIFMD.
- The Statistics Regulation Guidance indicates that structured issues which are not credit-linked (for example, debt securities linked to indices, commodities or equities), or structured issues where the transfer of credit risk could be viewed as accessory to the principal activity of the entity (possibly, *Sukuk*), or structured issues where there is no separation of the originator and issuer (possibly loan participation notes), may not fall within the definition of "securitisation". This could lead to uncertainty for such products and/or differential interpretation of the meaning of the term "securitisation" by market participants and regulators.

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<sup>9</sup> For example, the responses from industry bodies to ESMA's 2011 call for evidence in relation to the categories of investment manager and investment fund which fall within scope of the AIFMD and the summary of the mapping exercise ESMA carried out to establish to the extent possible the types of AIF which currently exist in the EU (summarised in the ESMA Discussion Paper published on 23 February 2011) do not make clear that structured issues have been taken into account by industry bodies/competent authorities.

<sup>10</sup> The ECB Guidance Note of 8 February 2012 on the definitions of "Financial Vehicle Corporation" and "securitisation" under Regulation ECB/2008/30 of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (such guidance the **ECB Guidance**).

- The JAC therefore seeks affirmation from ESMA that the Statistics Regulation Guidance should not determine the status of particular products for purposes of the interpretation of the definition "securitisation" as used in the SSPE exclusion in the AIFMD.
- One further aspect of the SSPE exclusion in relation to which it would be helpful to receive affirmation from ESMA is in relation to the meaning of the term "originator" used in the definition of "securitisation". As mentioned the AIFMD defines the term "securitisation" by reference to Article 1(2) of the Statistics Regulation.<sup>11</sup> Given that the term "originator" appears in the definition of "securitisation" taken from the Statistics Regulation, we assume the term "originator" should also be interpreted consistently with the meaning given to such term in the Statistics Regulation. The definition of "originator" in the Statistics Regulation is: "the transferor of the assets, or a pool of assets, and/or the credit risk of the asset or pool of assets to the securitisation structure." As a result it is irrelevant whether an entity purchases the assets directly from the original lender/issuer or from a third party. We believe this definition of "originator" is necessary in order to ensure there is sufficient clarity in respect of the scope of application of the AIFMD.

### **Conclusion**

Structured issues are an extremely important means of capital raising for banks and other financial counterparties, as well as (in the case of *Sukuk* and loan participation notes) Islamic entities and emerging market issuers. While the securitisation exemption is potentially helpful, uncertainty has been caused by the Statistics Regulation Guidance which was made for another purpose.

It is therefore important that:

- clarification is issued by ESMA in relation to the Statistics Regulation Guidance; and
- proper recognition of the role of structured issues is given by ESMA.

In both cases the amendments we have proposed to the Draft Guidelines on Key Concepts of the AIFMD in Appendix 2 are designed to do this.

We would be pleased to discuss any question you have on this. We believe it is very important these points are taken into account in order to avoid unintended consequences of the AIFMD regime.

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<sup>11</sup> Article 4(an) of the AIFMD.

## **APPENDIX 1 - RESPONSES TO RELEVANT QUESTIONS IN THE AIFMD KEY CONCEPTS CONSULTATION**

We have set out below our responses to the questions raised in the AIFMD Key Concepts Consultation which are relevant for JAC members in relation to structured issues.

**Q1: Do you agree with the approach suggested above on the topics which should be included in the guidelines on key concepts of the AIFMD? If not, please state the reasons for your answer and also specify which topics should be re-moved/included from the content of the guidelines.**

One of the topics covered in the ESMA Discussion Paper included: "the vehicles which are not AIFMs or AIFs or are exempted from the provisions of the AIFMD". This topic is not addressed in any of the AIFMD Key Concepts Consultation or the AIFMD Types of AIFM Consultation or the Level 2 delegated regulation. ESMA has not to date issued guidance on this topic and some of the responses to the ESMA Discussion Paper<sup>12</sup> indicate that in the absence of such guidance there could be different interpretations in the application of the Directive which is undesirable and could lead to an inconsistent application of the AIFMD in different Member States. Given that such guidance is outside the scope of the Level 2 text, the JAC therefore seeks affirmation from ESMA that structured issues will not be AIFs and therefore fall outside the scope of the AIFMD in accordance with our comments in the General Comments section above. As indicated above, the JAC also seeks affirmation from ESMA that the Statistics Regulation Guidance is not applicable to the interpretation of the definition "securitisation" as used in the SSPE exclusion in the AIFMD.

**Q2: What are your views on/readings of the concepts used in the definition of AIFs in the AIFMD? Do you agree with the orientations set out above on these concepts? Do you have any alternative/additional suggestions on the clarifications to be provided for these concepts?**

Subject to our comments on the specific content of the guidelines in this Appendix 1 and in Appendix 2, we consider it is helpful to have the guidelines on the concepts of "raising capital", "collective investment", "number of investors" and "defined investment policy" as set out in the AIFMD Key Concepts Consultation and agree that such guidelines should be relevant for the purposes of the AIFMD only and be without prejudice to the interpretation of similar concepts in other legislation. We also agree that it is only when all the elements included in the definition of AIFs under Article 4(1)(a) of the AIFMD are present that an entity should be considered to be an AIF.

**Q3: What are your views on the notion of 'raising capital'? Do you agree with the proposal set out above? If not, please provide explanations and possibly an alternative solution.**

We agree with the proposal subject to the drafting amendments contained in Appendix 2. The reason for our proposed drafting amendments is to clarify (in line with the Level 1 text) that an AIF raises capital with a view to investing such capital in accordance with a defined investment policy for the benefit of investors (i.e. where there is a direct link between the management of the pooled capital invested and the pooled return received by investors) and not for other purposes, for example, to purchase assets to hedge the issuer's obligations under a structured issue with a pre-defined payment profile (and not with a view to investing/managing assets acquired to generate pooled profit or income for the benefit of investors).

**Q4: Please provide qualitative and quantitative data on the costs and benefits that the proposed guidance on the notion of 'raising capital' would imply.**

Please see paragraph 6 (*Extent of market impact*) of the General Comments section above.

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<sup>12</sup> See footnote 5 above.



**Q5: Do you agree with the proposed guidance for identifying a ‘collective investment undertaking’ for the purposes of the definition of AIFs? If not, please explain why.**

We agree with the proposed guidance subject to our comments below (including our responses to Q6-Q8 inclusive which all relate to the guidelines on "collective investment undertaking") and the related drafting amendments contained in Appendix 2:

- in relation to the definition of "pooled return" relevant to the guidance for identifying a "collective investment undertaking" (as well as other concepts of the definition of AIFs), we note that the ESMA Discussion Paper states that a "collective investment undertaking should have the purpose of generating a return for investors through the sale of investments" and that the concepts of "acquiring" and "holding" investment assets have been introduced in the definition of "pooled return" in the AIFMD Key Concepts Consultation. We also note that this change was included as "ESMA saw merit in including under the clarifications provided for the notion of collective investment not only the sale of the AIF's investments, but also their management". Further to this change, we have suggested drafting amendments in Appendix 2 in order to further clarify that the guidelines could not inadvertently catch entities where investors do not benefit from (i.e. returns are not directly linked to) income or profits generated by the sale or management of the AIF's assets. For example: (i) undertakings issuing products with a pre-defined investment return; or (ii) undertakings acquiring assets for the purpose of custody/to hold such assets in a convenient form (as opposed to for investment);
- as indicated in our response to Q3 above, the pooled return should be stated to be managed to generate a pooled return for the benefit of investors (see Appendix 2 for suggested wording) for the reasons set out in response to Q3;
- in the context of clarifying the vehicles which are not AIFMs or AIFs, it would also be helpful for ESMA to affirm our understanding that the reference to "collective investment undertakings, including investment compartments thereof" in the definition of AIFs in the AIFMD is intended to acknowledge that some investment compartments or contractually ring-fenced obligations comprised with a single collective investment undertaking may constitute AIFs, whereas other investment compartments or contractually ring-fenced obligations of the same collective investment undertaking may not do so. As a result we would request that ESMA clarify that the determination as to whether the collective investment undertaking constitutes an AIF or falls within one of the exclusions to the AIFMD should be made at the level of each investment compartment or contractually ring-fenced obligation only and without regard to other investment compartments or contractually ring-fenced obligations; and
- it is vital for undertakings to be certain whether or not they are AIFs for the purposes of the AIFMD. We acknowledge that the guidelines are only guidelines not definitive checklists and in no way alter the provisions of the AIFMD (as expressly stated in Annex V, paragraph III, subparagraph 4 of the guidelines and the use of words such as "indicate"). It is however important that ESMA acknowledges institutions may place reliance on the guidelines when assessing whether or not entities fall within the scope of the AIFMD, particularly since these concepts are not defined in the Level 1 text. We would therefore request that the following wording contained in Annex V, paragraph VI, sub-paragraph 10 (which was not contained in the ESMA Discussion Paper) is removed from the guidelines on the basis that this undermines the stated purpose of the of the guidelines to ensure common, uniform and consistent application of the concepts in the definition of "AIF" in Article 4(1)(a) of the AIFMD by effectively conferring discretion on individual competent authorities to conclude that an undertaking is a collective investment undertaking notwithstanding the fact that it does not have one or more of the identified characteristics:

*"10. The determination of the above characteristics showing that an undertaking is a collective investment undertaking should be without prejudice to the fact that competent authorities and market participants should not consider that the absence of all or any one of them conclusively demonstrates that the undertaking is not a collective investment undertaking."*

**Q6: Please provide qualitative and quantitative data on the costs and benefits that the proposed guidance for identifying a ‘collective investment undertaking’ would imply.**

Please see paragraph 6 (*Extent of market impact*) of the General Comments section above.

**Q7: Do you agree with the analysis on the absence of any day-to-day investor discretion or control of the underlying assets in an AIF? If not, please explain why.**

We agree with the analysis that the unitholders or shareholders should not have day-to-day discretion or control over the management of the undertakings' assets and that such control should instead be exercised by the AIFM. This amendment is in line with ESMA's statement in paragraph 23 of the AIFMD Key Concepts Consultation that "*ESMA proposes to clarify that the AIFM should have responsibility for the management of the AIF's assets. Investors should not have day-to-day discretion or control over such assets*". This is an important distinction between an investment fund which is an AIF and a structured issue where assets may be purchased as a hedge (as opposed to by way of investment for the benefit of investors), and no entity has any day-to-day discretion or control over the management of such assets, payments on the securities being determined by reference to a pre-defined payout profile. We would however propose the amendments contained in Appendix 2 (in relation to paragraph VI, sub-paragraph 9(c) of the guidelines on "collective investment undertaking") in order to further clarify this distinction.

**Q8: Do you agree that an ordinary company with general commercial purpose should not be considered a collective investment undertaking? If not, please explain why.**

Yes – see paragraph 2 of the General Comments section above entitled "This is because structured issues are for raising capital for a bank or other financial counterparty – i.e. a financial intermediation".

**Q9: Which are in your view the key characteristics defining an ordinary company with general commercial purpose?**

No comment.

**Q10: Do you agree with the proposed guidance for determining whether a ‘number of investors’ exists for the purposes of the definition of AIFs? If not, please explain why.**

We agree with the guidance subject to our comment in Q5 above that where a collective investment undertaking is comprised of more than one investment compartment or contractually ring-fenced obligation, the determination as to whether that collective investment undertaking is an AIF should be made at the level of each investment compartment or contractually ring-fenced obligation only. In accordance with this comment, we believe it would be helpful to clarify that to the extent that one investment compartment or contractually ring-fenced obligation of a collective undertaking is prevented by its national law, the rules or instruments of incorporation, or any other provision or arrangement of binding legal effect, from having more than one investor such investment compartment should not be considered to be an AIF (notwithstanding that other ring-fenced investment compartments of the same collective investment undertaking may be permitted to raise capital from more than one investor).

**Q11: Please provide qualitative and quantitative data on the costs and benefits that the proposed guidance for determining whether a ‘number of investors’ exists would imply.**

Please see paragraph (6) (*Extent of market impact*) of the General Comments section above.

**Q12: Do you agree with the proposed indicative criteria for determining whether a ‘defined investment policy’ exists for the purposes of the definition of AIF? If not, please explain why.**

We agree with the proposed indicative criteria subject to the following comments:

- as indicated in our response to Q3 above, the pooled return should be stated to be managed to generate a pooled return for the benefit of investors (see Appendix 2 for suggested wording) for the reasons set out in response to Q3;
- our comment in response to Q5 above in relation to amendments to the definition of "pooled return" also applies to this proposed indicative criteria;
- in line with our response to Q7 above, we would also request that minor amendments are made to Annex V, paragraph IX, sub-paragraphs 16 and 17 (as indicated in Appendix 2) with a view to clarifying that a "defined investment policy" requires investment management criteria and ongoing management activities to further clarify that structured issues (which may be custody arrangements or an arrangements for holding an asset in a convenient form or which have a pre-defined payout profile) could not be inadvertently seen to have a "defined investment policy";
- we believe these factors should be viewed in aggregate (and it should not be the case that the satisfaction of one factor indicates the presence of a "defined investment policy") and hence request that the words "singly or cumulatively" are deleted from Annex V, paragraph IX, subparagraph 16 (as per our suggested drafting amendments);
- as stated in our response to Q5 above, it is vital for undertakings to be certain whether or not they are AIFs for the purposes of the AIFMD. We acknowledge that the guidelines are only indicative guidelines and in no way alter the provisions of the AIFMD (as expressly stated in paragraph III, subparagraph 4 of the guidelines) it is however important that ESMA acknowledges institutions may place some reliance on the guidelines when assessing whether or not entities fall within the scope of the AIFMD given that key concepts used in the definition of AIFs are not defined in the AIFMD itself. In the context of this comment, we would therefore request that the following wording contained in Annex V, paragraph IX, subparagraph 18 (which was not contained in the ESMA Discussion Paper) is removed from the guidelines:

*"18. The determination of factors tending to indicate the existence of a defined investment policy should be without prejudice to the fact that competent authorities and market participants should not consider that the absence of all or any one of them conclusively demonstrates that no such policy exists."*

Similarly we propose that the wording of Annex V, paragraph IX, sub-paragraph 1 which states: "*The factors which could, singly or cumulatively, tend to indicate the existence of such a policy are the following ones*" is amended to state: "The factors, that indicate the existence of such an investment policy". The use of the word "could" and the words "tend to" mean uncertainty for competent authorities/market participants. In addition, we believe the inclusion of this provision which effectively confers discretion on individual competent authorities to conclude that an undertaking has a defined investment policy notwithstanding

the fact that one or all of the factors indicating the existence of such a policy are absent undermines that stated purpose of the guidelines to ensure common, uniform and consistent application of the concepts in the definition of "AIF" in Article 4(1)(a) of the AIFMD.

**Q13: Please provide qualitative and quantitative data on the costs and benefits that the proposed indicative criteria for determining whether a ‘defined investment policy’ exists would imply.**

Please see paragraph (6) (*Extent of market impact*) of the General Comments section above.

**Q14: Do you consider appropriate to add in Section IX, paragraph 16(b) of the draft guidelines (see Annex V) a reference to the national legislation among the places where (in addition to the rules or instruments of incorporation of the undertaking) the investment policy of an undertaking is referenced to?**

No comment.

**APPENDIX 2 - PROPOSED DRAFTING AMENDMENTS TO DRAFT GUIDELINES ON  
KEY CONCEPTS OF THE AIFMD**

**Annex V – Draft guidelines on key concepts of the AIFMD**

**I. Scope**

**Who?**

1. These guidelines apply to AIFMs and competent authorities.

**What?**

2. These guidelines apply in relation to Article 4(1)(a) of the AIFMD.

**When?**

3. These guidelines apply from 22 July 2013.

**II. Definitions**

Unless otherwise specified, terms used in the Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/20108 (**AIFMD**) have the same meaning in these guidelines. In addition, the following definitions apply:

*pre-existing group*

in connection with investment in a collective investment undertaking, a group of persons connected by a close familial relationship that pre-dates the establishment of the undertaking.

*pooled return*

the participation by investors in the profits or income generated by the pooled risk directly arising from acquiring, holding or selling investment assets as opposed to a pre-defined investment return or the return generated by the activity of an entity acting for its own account and whose purpose is to manage the underlying assets as part of a commercial or entrepreneurial activity, irrespective of whether different returns to investors, such as under a tailored dividend policy, are generated.

**III. Purpose**

4. The purpose of these guidelines is to ensure common, uniform and consistent application of the concepts in the definition of ‘AIF’ in Article 4(1)(a) of the AIFMD by providing clarification on each of these concepts. Nevertheless appropriate consideration should be given to the interaction between the individual concepts of the definition of AIFs, which should be considered together. By way of example, undertakings, or investment

compartments (which term will include any contractually ring-fenced obligations) thereof, which do raise capital from a number of investors, but do not do so with a view to investing it in accordance with a defined investment policy, should not be considered AIFs for the purposes of the AIFMD. The additional details provided by these guidelines in no way alter the provisions of the AIFMD.

#### **IV. Compliance and reporting obligations**

##### **Status of the guidelines**

5. This document contains guidelines issued under Article 16 of the ESMA Regulation<sup>9</sup>. In accordance with Article 16(3) of the ESMA Regulation competent authorities and financial market participants must make every effort to comply with guidelines and recommendations.
6. Competent authorities to whom the guidelines apply should comply by incorporating them into their supervisory practices, including where particular guidelines within the document are directed primarily at financial market participants.

##### **V. Reporting requirements**

7. Competent authorities to which these guidelines apply must notify ESMA whether they comply or intend to comply with the guidelines, with reasons for non-compliance, within two months of the date of publication by ESMA to [email address]. In the absence of a response by this deadline, competent authorities will be considered as non-compliant. A template for notifications is available from the ESMA website.
8. AIFMs are not required to report whether they comply with these guidelines.

#### **VI. Guidelines on ‘collective investment undertaking’**

9. The following characteristics, if all of them are exhibited by an undertaking or an investment compartment of it, should show that the undertaking, or the investment compartment, is a collective investment undertaking mentioned in Article 4(1)(a) of the AIFMD. The characteristics are that the undertaking, or the investment compartment, as the case may be:
  - (a) is not an ordinary company with general commercial purpose;
  - (b) pools together capital raised from its investors for the purpose of investment with a view to managing such investment to generate a *pooled return* for the benefit of those investors (whether or not different investors receive returns on different bases); and
  - (c) the unitholders or shareholders of it have no day-to-day discretion or control over the management of the undertakings’ assets (such day-to-day discretion or control over the management of the undertakings’ assets instead being exercised by the AIFM).
10. In the case of a collective investment undertaking comprised of different investment compartments, the determination as to whether the collective investment undertaking constitutes an AIF or falls within one of the exclusions to the AIFMD shall be made at the

level of the relevant investment compartment only (and without regard to other investment compartments of such collective investment undertaking).

## **VII.Guidelines on ‘raising capital’**

11. An activity with the following characteristics when carried out by an undertaking by way of business should amount to the activity of raising capital mentioned in Article 4(1)(a)(i) of the AIFMD:
  - (a) taking direct or indirect steps to procure the transfer or commitment of capital by one or more investors to an undertaking for the purpose of investment with a view to managing such investment to generate a *pooled return* by investment in specified underlying assets for the benefit of investors; and/or
  - (b) commercial communication between the undertaking seeking capital or a person or entity acting on its behalf (typically, the AIFM), and the prospective investors, which aims at procuring the transfer of investors’ capital.
12. It is immaterial whether these activities take place only once (as in the case of the initial subscription to a closed-ended fund), on several occasions or on an ongoing basis (as with certain open-ended funds).
13. Without prejudice to paragraph 14, when capital is invested in an undertaking by a natural or legal person or body of persons who is one of the following:
  - (a) a member of the governing body of that undertaking or the legal person managing that undertaking;
  - (b) an employee of the undertaking or of the legal person managing the undertaking whose professional activities have a material impact on the risk profiles of the undertakings they manage and into which he or she invests; or
  - (c) a member of a pre-existing group, for the investment of whose private wealth the undertaking has been exclusively established,

this is not likely to be within the scope of raising capital.

14. The fact that an investor being one of the natural or legal persons or body of persons mentioned under paragraph 13 invests alongside an investor not being one of the natural or legal persons or body of persons mentioned under paragraph 13 should not have the consequence that the criterion ‘raising capital’ is not fulfilled. Whenever such a situation does arise, the investor not being one of the natural or legal persons or body of persons mentioned under paragraph 13 should enjoy full rights under the AIFMD.

## **VIII. Guidelines on ‘number of investors’**

15. A collective investment undertaking which is not prevented by its national law, the rules or instruments of incorporation, or any other provision or arrangement of binding legal effect, from raising capital from more than one investor should be regarded as a collective investment undertaking which raises capital from a number of investors in accordance with Article 4(1)(a)(i) of the AIFMD. This should be the case even if:

- (a) it has in fact only one investor; or
- (b) if a sole investor invests funds which it has raised from more than one legal or natural person for the benefit of those persons as in the case of nominee arrangements, feeder structures or fund of fund structures that have more than one investor for the purposes of the AIFMD.

## **IX. Guidelines on ‘defined investment policy’**

16. An undertaking which has an investment policy about how the pooled capital in the undertaking is to be invested in specified underlying assets and managed over time to generate a *pooled return* for the benefit of investors from whom it has been raised should be considered to have a defined investment policy for the purposes of the AIFMD. The factors that indicate the existence of such an investment policy are the following ones:

- (a) the investment policy is determined and fixed, at the latest by the time that investors’ commitments to the undertaking become binding on them;
- (b) the investment policy is set out in a document which becomes part of or is referenced in the rules or instruments of incorporation of the undertaking;
- (c) the undertaking or the entity managing it has an obligation (however arising) to investors, which is legally enforceable by them, to follow the investment policy, including all changes to it;
- (d) the investment policy specifies investment guidelines conferring day-to-day discretion and control over the management of the undertaking’s assets, with reference to criteria including the following:
  - (i) to invest in certain categories of asset, or conform to restrictions on asset allocation;
  - (ii) to pursue certain strategies;
  - (iii) to invest in particular geographical regions;
  - (iv) to conform to restrictions on leverage;
  - (v) to conform to minimum holding periods; or
  - (vi) to conform to other restrictions designed to provide risk diversification.

17. In paragraph 16(d), any guidelines given for the management over time of an undertaking's investments (or the investments of the relevant investment compartment) which determine investment management criteria conferring day-to-day discretion and control over the management of the undertakings' assets for purposes other than those set out in the business strategy followed by an ordinary company with general commercial purpose should be regarded as ‘investment guidelines’.

## **X. Guidelines on "securitisation special purpose entities"**



18. In interpreting the definition of "securitisation special purpose entities" in Article 2(3)(g) of the AIFMD, for the avoidance of doubt, the ECB Guidance Note of 8 February 2012 on the definitions of "Financial Vehicle Corporation" and "Securitisation" under Regulation ECB/2008/30 of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions should not determine whether particular financial products constitute a securitisation as referred to in such definition.
  
19. Article 4(an) of the AIFMD states that the definition of "securitisation" has the meaning given to such term in Article 1(2) of Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 (**ECB 2008/30**). The term "originator" as used in the definition of "securitisation" in ECB 2008/30 should be interpreted consistently with ECB 2008/30 and the meaning given to such term in Article 1(3) of ECB 2008/30.

## **APPENDIX 3**

### **PARTICIPATING ASSOCIATIONS**

#### **About the Joint Associations Committee**

The JAC is sponsored by multiple associations with an interest in structured products, including the International Swaps and Derivatives Association (ISDA), the International Capital Market Association (ICMA), the Association for Financial Markets in Europe (AFME), the British Bankers' Association, the Asia Securities Industry & Financial Markets Association (ASIFMA), SIFMA, the Associazione Italiana Intermediari Mobiliari (ASSOSIM), the Institute of International Finance, Inc. (IIF) and the UK Structured Products Association (UK SPA). The members of the JAC comprise most of the major firms (both financial institutions and law firms) involved in the creation and, to some extent, distribution of structured securities which are distributed to retail investors.

#### **About AFME**

AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan- EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME was formed on 1st November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and Financial Markets Association.

AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA) and is an affiliate of the US Securities Industry and Financial Markets Association (SIFMA) and the Asian Securities Industry and Financial Markets Association (ASIFMA). For more information, visit the AFME website, [www.AFME.eu](http://www.AFME.eu).

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76

#### **About ICMA**

ICMA represents financial institutions active in the international capital markets; its members are located in 50 countries, including all the world's main financial centres. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years, providing the framework of rules governing market practice which facilitate the orderly functioning of the market. ICMA actively promotes the efficiency and cost effectiveness of the capital markets by bringing together market participants and regulatory authorities. For more information see: [www.icmagroup.org](http://www.icmagroup.org).

ICMA is listed on the EU Register of Interest Representatives, registration number 0223480577-59

#### **About ISDA**

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: [www.isda.org](http://www.isda.org).

ISDA is listed on the EU Register of Interest Representatives, registration number: 46643241096-93