Level 2 measures of the Alternative Investment Fund Managers Directive. November 2011.

ESMA has published, on the 16 of November, the final report with the technical advice to eh EC on possible implementing measures of the Alternative Investment Fund Managers Directive (AIFMD). The document covers the areas that, according to level 1 Directive, should be implemented in the level 2:

Application scope

The total value of assets under management, for the purpose of calculating is the managers overstep the threshold for the Directive application (100 millions euros or 50 millions euros in closed no leveraged funds) should be calculated at least annually using the latest available asset value calculation and should include assets acquired through leverage; each financial derivative instrument position should be converted into its equivalent position in the underlying assets of that derivative using the conversion methodologies, and large and short positions should be should be taken into account except foreign exchange and interest rate hedging positions that according to the investment strategy of the AIF are not used to generate a return. Also, register obligations are concreted in situations in which managers below the threshold exceed them not occasionally, and the opt-in procedure is described for those entities that falling below the threshold, apply voluntarily to be subject to the Directive.

Managers organisational requirements

The reports takes as a starting point some of the equivalent provisions of the UCITS and MiFID directives but with some adjustments and makes proposals on general organisational provisions, risk management, liquidity management and conflicts of interest.
The coverage of risks arising form professional negligence could be done with additional own funds of the 0,01% of assets managed or the professional indemnity insurance or, in some circumstances, the combination of both.

Other proposals are referred to valuations (the valuation of assets that are not financial instruments must take place at least once a year), investment in securitisation positions (requirements for originators and managers) and delegation of AIFM functions.

Depositaries regime

The duties of the depositary are described: on one hand, and to oversee the compliance with the AIF´s rules and instruments of incorporation and with applicable law and regulation and, on the other hand, to safekeep the AIF´s assets on a way depending on the type of asset. The financial instruments that should be included in the depositary´s custody functions are transferable securities, money market instruments or units of collective investment undertakings that have not been provided as collateral and are registered or held in an account directly or indirectly in the name of the depositary, excluding derivatives since they are directly registered with the issuer itself or its agent.

In relation to assets not covered by custody, the depositary should verify the ownership and register in its record, in the name of the AIF, the assets and should be able at any time a comprehensive and up-to-date inventory of the AIF´s assets, to that end, the depositary have access to documentary evidence of each transaction and positions from the relevant third party on a timely basis. The cash should be treated as assets not covered by custody, the depositary should verify manager procedures to inform the depositary, and check the consistency between the cash positions in its records with those of the AIFM and set up and implement an escalation process for situations where an anomaly is detected.

Depositary ´s liability regime consists on the replacement of the assets lost when its loss is not cause by external event beyond the depositary´s reasonable control so that, in case of insolvency of a sub-custodian, fraud of the depositary or sub-custodian and operative failures, the depositary retains the liability. However, central counterparties or settlement systems failures are considered as external events. In the particular case of insolvency of the sub-custodian, when the assets are lost following the liquidation of a sub-custodian despite appropriate segregation of assets,, because the law of the country where the financial instruments were held in custody does not recognise the effects of segregation, The depositary is no liable for those assets.

Transparency requirements and leverage.

The methodologies to be adopted for calculation of leverage are: first, gross method; second, commitment method based in the UCITS regulation; and third, advanced method, that can be proposed by the manager if it is considered convenient in all cases in addition to the two mandatory methods mentioned before.

Reporting requirements to authorities and investors are defined. The annual reporting requirements: balance sheet, income and expenditure account, report on activities and remuneration disclosure. The periodic and regular disclosures to investors should include arrangements for managing the liquidity (percentage of assets subject to special arrangements) the risk profile, the systems employed to manage risk and the information about the leverage employed. The information that must be made available to competent authorities include markets and instruments in which AIFs trade, the sources of leverage and their most important concentrations.

Cooperation with third country authorities.

The cooperation arrangement between EU and non-EU competent authorities should be in writing and provide for exchange of information for supervisory and enforcement purposes, and for the ability to obtain all information necessary for the performance of the duties described in the Directive and to carry out an on-site inspections.

To have access to ESMA document, please do click on: http://www.esma.europa.eu/popup2.php?id=8059