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Submitted via online questionnaire

Mr Sven Gentner
Head of Unit for Asset Management
DG FISMA
Rue de Spa 2
1000 Brussels
Belgium

29 January 2016

Dear Mr Gentner,

Re: Call for Evidence on the EU Regulatory Framework for Financial Services

Irish Funds is the representative body for the international investment fund community in Ireland. Founded in 1991, we represent fund managers, administrators, depositaries, transfer agents, professional advisory firms and other specialist firms involved in the international fund services industry in Ireland. Irish Funds' 100+ members are responsible for in excess of 13,000 funds with a net asset value of €3.6 trillion. Our members manage, service and advise UCITS and AIFs spanning the complete range of assets classes and strategies. We welcome the Commission's invitation to review the EU's regulatory framework for financial services in its entirety in order to bring greater coherence, clarity and efficiency with a single rulebook and crucially, to enable the Capital Markets Union project to succeed.

In this submission we have sought to provide the Commission with feedback and suggested solutions to address the most impactful issues arising from the perspective of the cross-border funds industry. With over €5 trillion in AuM and growth exceeding 70% over the past four years, the cross-border funds industry in Europe presents significant potential to channel further investment into the European economy (Source: EFAMA, Q3 2015). The cross-border funds industry in Europe has grown in scale and significance for many reasons. One of these is undoubtedly its regulated status, therefore we understand the importance of clear and effective regulation. However, the cumulative impact of the intensive rule-making undertaken over the past five years has also resulted in significant additional costs and obligations, the benefits of which are not always entirely apparent. Additionally, the continuously changing regulatory environment has created considerable uncertainty and instability for those seeking to provide fund based solutions which channel savings directly and indirectly into the economy. Given the ability of the cross border funds industry (which is global in reach) to act as a positive agent in attracting external investment, it is also important to consider how European rules impact on the attractiveness of UCITS and AIFs and the efficiency of the European regulatory environment.

We therefore welcome this Call for Evidence and would make the following remarks which complement our submission via the online questionnaire:

- **The process of initiating, developing, validating and implementing legislation (in terms of clarity, efficiency and effectiveness) has as much of a bearing on its impact (from a policy, regulatory and commercial perspective) as the detail of the underlying measures.** There is significant detail devoted in our submission to the specifics of individual policy or legislative measures and their inter-relationships with each other, as requested in the call for evidence. However, we urge the Commission to look closely at the processes which deliver regulation both to authorised/regulated entities and to the end consumer, as these are equally important. Even the best idea or initiative can be compromised or diminished in its impact through poor "delivery" processes. This point is elaborated on below by reference to specific parts of the delivery process.

- **Unrealistically tight deadlines coupled with delays in the detailed implementing measures and the issuing of guidance is a source of major concern and uncertainty**. Those entities in scope of a new regulation cannot generally prepare for its implementation before the detailed requirements are known, and as the delegated instruments may themselves take a considerable amount of time to adopt, firms frequently have very little time in which to prepare for significant and costly changes to implementation. Implementation timelines should be realistic and take into account that in many circumstances entities within scope can only begin to prepare for implementation once Level 2 and Level 3 measures are finalised. AIFMD, UCITS V, EMIR and MiFID II provide examples of how the detailed measures have been delayed. We would like the Commission to appreciate that the European Supervisory Authorities ("**ESAs**") need sufficient time to prepare technical advice, regulatory technical standards and guidance and this needs to be appropriately reflected in the overall timeframe from proposal to implementation. Any delays on the Commission side have a knock on effect on timeframes further downstream. National Competent Authorities can be left trying to clarify workable transitional arrangements, as those within scope have not been given enough time to prepare. In keeping with the position frequently adopted by the European Parliament's ECON Committee, mandates for the drafting of Level 2 texts should set a timeframe of 12-24 months (depending on the complexity, scale and level of change required) to run from the date upon which the relevant Level 1 text enters into force.

- **A period of regulatory stability is needed following the comprehensive changes made to the regulatory framework**. The regulatory framework relevant to fund and portfolio management has been overhauled in recent years under AIFMD and UCITS V and further changes will continue to impact under MMFR, MiFID II/MiFIR, MAD II, PRIIPS, EMIR, SFTR, the EU Benchmarks Regulation, Solvency II, CRD IV, the Fourth AML Directive and the EU Audit Directive. ESMA has issued numerous regulatory technical standards, guidelines and Q&A, often to implement these frameworks but also on its own initiative (e.g. ESMA's guidelines on ETFs and other UCITS issues). On top of this, national regulators have taken up their own initiatives involving for example the re-writing of rulebooks, undertaking themed reviews, devising new supervisory systems, new client asset requirements, new governance and organisational requirements and new rules on distribution. The cumulative effect is a challenging regulatory environment in a state of flux, which, coupled with tight timeframes, delays and points of uncertainty ultimately makes it harder for a fund manager to do business in Europe and very difficult to promote start-ups and the diversity in the financial sector that CMU seeks to promote.

- **Changes to EU financial services legislation should only be made in line with a joined-up approach to policy making**. Many individual pieces of legislation have been developed in isolation creating unhelpful overlap, duplication and inconsistencies. We welcome the Commission's invitation to look at these issues and ask that all future legislative initiatives follow the integrated policy-making approach envisaged under CMU with a single and consistent rulebook. Each piece of EU legislation generally has its own built-in review period. We would urge the Commission in undertaking these reviews to focus on making requirements more cohesive, clearer, more efficient and ultimately more effective rather than seeking to layer on further rules. Appropriate timeframes should be set for consultation, allowing for the reality that many other regulatory activities both at the EU and Member State levels will be running concurrently.

- **The approach to rulemaking combined with tight deadlines is creating significant downstream impacts, particularly in the area of regulatory reporting**, which has become a very significant burden in meeting all of the various requirements stemming from both EU and domestic reporting requirements. Reporting requirements have largely been devised on a sectoral basis, leading to a degree of incoherence between the various sectors and inconsistencies in relation to content, classifications, frequency, format and destination. Managers and service providers are having to develop multiple parallel costly reporting capabilities and regulatory authorities are not receiving this information in a single standardised format across all regulatory frameworks which would allow them to assess data with greater ease to monitor macroprudential risks. Smaller firms are particularly impacted as they have less resources at their disposal to undertake the reporting but larger players operating cross-border also face the challenge of local regulators adapting requirements and applying different interpretations and formats to EU level reporting requirements. Local regulators also impose their own investment funds reporting which can overlap significantly but with different classifications and formats. The net result is an immense drain on resources that could be more productively deployed elsewhere. We are unclear as to the practical policy or regulatory benefits which have accrued from this highly fragmented approach. In response we propose that the EU develop an integrated reporting strategy and a single coherent, streamlined reporting framework with reporting via a single EU portal to create efficiencies and enable better access to and monitoring of data by regulators and policy makers.

- **Ease of cross-border fund distribution is pivotal to CMU and further efficiencies and cost reductions should be made in this area.** Cross-border funds are a highly effective mechanism for aggregating and deploying investor capital. In our submission we have drawn attention to the level of fees imposed for local notifications, outdated requirements regarding the appointment of local facilities agents, gold-plating with respect to documentation and inconsistencies in relation to response timeframes. EU passporting has been immensely beneficial to the European funds market and a major policy success; it is critical that the relevant EU passports live up to their objective of providing ease of access without local barriers or gold-plating in markets across the EU.

- **An appropriate tax environment for investment funds is critical to the success of CMU**. Withholding taxes on interest and dividend payments are a key tax barrier to the success of CMU. The abolition of such taxes (or at least the introduction of a minimum standard rate) would help bring the EU treatment of the taxation of such payments closer in line with the treatment adopted across constituent states in a common capital market such as the US. The final recommendations in Action 6 of the OECD's BEPS project are of particular concern, as they may restrict the ability of Collective Investment Vehicles ("**CIVs**") to access tax treaties and could promote a fragmentation of investment funds along domestic lines, which runs contrary to the objectives of CMU. While we acknowledge the work undertaken by the European Commission on this issue to date, we would encourage the Commission to provide further clarity on the entitlement of EU resident CIVs to treaty benefits, as outlined in this submission. The introduction of a common European Financial Transactions Tax should be resisted as it has the potential to create a significant barrier to the success of CMU by increasing costs and reducing liquidity.

- **Money Market Funds constitute a vital part of CMU** as providers of financing and liquidity in the economy. In particular, the treatment of constant NAV ("**CNAV**") money market funds under the proposed Money Market Fund Regulation needs to be proportionate and provide investors with options suited to their requirements while also not jeopardising important funding sources for European banks and businesses. It is not necessary or desirable from a CMU perspective to eliminate CNAV in Europe in order to address the risks identified.

- **Providing alternatives to bank finance is a critical aspect of CMU and therefore it is imperative that barriers to non-bank lending are removed and that a level playing field operates across Europe with respect to loan origination via investment funds.** We would welcome the harmonisation of conditions for loan origination across the EU. In doing so we would emphasise the need to strike the right balance in regulating loan origination that will enable this activity to grow in line with the policy objectives of CMU. In addition to the development of an appropriate EU framework for loan origination, local barriers to deploying these funds for lending need to be removed. In several Member States, only entities with a banking license can lend and legislative preference is in many cases given to banks over funds. This is not consistent with the objectives of CMU and should change.

- **In recognition of the globalised market in which EU cross-border funds operate, EU rules need to be flexible enough to facilitate the different market practices, legal systems and protections afforded in other markets** with regard to depositary duties and asset segregation requirements and also in relation to the application of remuneration requirements. Depositaries have a duty to act in the best interests of investors at all times and to put in place the most appropriate segregation arrangements in a particular market. Imposing a single model of more granular physical account segregation will not enhance investor protection in all cases (and may reduce it in some) but will lead to increased costs and operational risks as well as locking EU funds out of certain markets. Likewise, intermediary Central Securities Depositories ("**CSDs**") should not be treated under the UCITS or AIFMD frameworks as depositary sub-delegates in the course of the performance of their role as mandated market infrastructure under interoperability arrangements such as Target2Securities and Shanghai-Hong Kong Stock Connect.

The remuneration look-through applied to non-EU delegates under AIFMD and UCITS creates a myriad of challenges in seeking to apportion such rules and conditions to non-EU delegates who are frequently used in the context of cross-border investment funds. It is important to apply a proportionate approach in dealing with these delegates who are subject to entirely different requirements in their own jurisdictions, particularly when these requirements seek to align remuneration and risk in order to protect financial stability.

We look forward to continuing the dialogue with the Commission on the CMU Action Plan and would be happy to discuss any aspect of this submission with you in further detail.

Yours sincerely,

Patrick J Lardner

Patrick Lardner
Chief Executive

Answers to questionnaire

Issue 1 – Unnecessary regulatory constraints on financing

The Commission launched a consultation in July on the impact of the Capital Requirements Regulation on bank financing of the economy. In addition to the feedback provided to that consultation, please identify undue obstacles to the ability of the wider financial sector to finance the economy, with a particular focus on SME financing, long-term innovation and infrastructure projects and climate finance. Where possible, please provide quantitative estimates to support your assessment.

Example 1

The potential for the EU's proposed Money Market Fund Regulation to further widen the funding gap in the EU's economy

Legislation

Proposal for a Regulation of the European Parliament and the Council on Money Market Funds (COM(2013)615)

European Parliament Report on the proposal for a Regulation of the European Parliament and of the Council on Money Market Funds (A8-0041/2015)

Summary of issue

Both the Commission and the European Parliament proposals on the Money Market Fund Regulation ("**MMFR**") would decimate the money market fund industry in Europe with a very significant spill-over effect on funding to European banks and businesses.

An appropriate solution needs to be found for the treatment of constant net asset value ("**CNAV**") money market funds ("**MMFs**") which addresses the policy objectives through a robust regulatory framework, while at the same time reflecting investor requirements.

Applying a capital buffer to CNAV MMFs has at this stage been largely discredited, with much evidence provided on the disproportionate cost and ineffectiveness of such a mechanism. We therefore do not propose to dwell on this mechanism as a potential solution. Likewise, we would hope that the outright banning or transitioning out of CNAV MMFs is no longer considered a feasible option, as it is not the case that existing CNAVs will convert into variable NAV ("**VNAV**") MMFs due to reduced investor demand, a move to bank deposits (with impacts to bank's capital charges) and a move to non-EU offshore CNAVs. The elimination of CNAV in Europe would also result in the drying up of existing funding to banks and corporates, which is the opposite of what CMU seeks to achieve and will exacerbate Europe's funding gap.

Given these realities, the European Parliament Report on MMFR sought to develop a compromise solution based on three alternative products to existing prime institutional CNAV. However, each of these products has serious fundamental flaws that will lead to decimation of the CNAV industry:

- The Low Volatility NAV ("**LVNAV**") MMF includes a sunset clause whereby authorisations will lapse after five years. As a new type of compromise product, much effort would need to be expended in making this product operationally workable and in convincing existing CNAV investors to use it. However, there will be no market for a new product which is already being phased out – this sends out entirely the wrong signal to investors. A sunset clause will have the same effect in the market as banning CNAV.

- The requirement under the Public Debt CNAV to invest as least 80% of assets in EU public debt by 2020 is not feasible given the scarcity of sufficiently high quality government paper in Europe and the need to be able to able to offer MMFs denominated in all major trading currencies and USD in particular.

- The Retail CNAV would be available to such a narrow pool of investors (charities, non-profit organisations, public authorities and public foundations) that it would not be viable to run. In order to make this option workable it would need to include pension funds, or accounts where the ultimate beneficiary is a natural person.

The EU's commitment to the creation of a genuine Capital Markets Union can only succeed with a functioning and effective MMF sector and the current proposals add unnecessary risks to the achievement of this goal. When negotiations commence in the Council of Ministers and move to trilogue stage, we urge the Commission, Member States and the European Parliament to agree a compromise solution that will not damage the important financing provided by MMFs.

Supporting relevant and verifiable empirical evidence

European Parliament Impact Assessment on MMFs

In March 2015 the European Parliamentary Research Service published an Impact Assessment of Substantive EP Amendments in relation to Money Market Funds (PE 545.547). The study concluded that there would very limited take up of the proposed Retail CNAV and EU Public Debt CNAV Money Market Funds and that the net effect would be the same as that of the Commission proposal, i.e. the provision of only VNAV and a move to bank deposits or other investments with the associated consequences of that move.

In relation to EU Public Debt CNAV, the Parliament's Impact Assessment highlighted that "less than 9 per cent of funds and less than 1 per cent of funds under management are accounted for by euro- or sterling-denominated government funds". The Impact Assessment highlighted the low yielding nature of suitable EU public debt assets, the limited demand for such products and that the fixed costs of setting up such funds would not justify operators continuing to provide CNAV funds for such a small portion of the market. In summary, the Impact Assessment found that the existing CNAV offering could not be accommodated within a new EU Public Debt CNAV exemption

The Retail CNAV did not fare any better under the Impact Assessment. It highlighted that "at present, only around 7 per cent of assets under management come from investors that would be classified as "retail" (and, on some estimates, less than this). That is in stark contrast to the much larger "retail" segment of the US money market funds industry, where retail funds constitute around one third of all funds". This fundamental difference with the US market must be taken into account in devising appropriate CNAV solutions in a European context. The Impact Assessment cited the loss of economies of scale and the attendant risks with a higher correlation of investor behaviour among a very homogenous investor group as the primary reasons that the take-up of Retail CNAV would not be sufficiently material.

Impact of constraints on the LVNAV

The European Parliament's Impact Assessment did not cover the LVNAV but would have undoubtedly concluded that the sunset clause attached to this product would have led to limited if any take-up. While there are features of this product that existing investors would find appealing, such as the ability to round the NAV to 2 decimal places and the ability to use amortised cost accounting for assets with a residual maturity below 90 days, the LVNAV presents several operational challenges. The most significant is the imposition of a mandatory conversion to VNAV if the constant NAV per share deviates from the actual NAV by more than 20 basis points. This is considered a very tight threshold for MMF managers to operate within. It does not take into account various factors that will be relevant in future market conditions such as the ban on sponsor support, the potential for higher interest rate movements, more sophisticated price modelling, the switch from bid to mid pricing and the shadow pricing relief provided by regulators in 2008/2009. Mandatory conversion to VNAV should only be triggered in exceptional market conditions, which we understand to be the policy intention. Setting too tight a conversion threshold will put investors off the product and make it operationally unworkable. Supporting data is available from the Institutional Money Market Funds Association (IMMFA) on this point.

Potential impact of EU MMF reform on European funding

CNAV MMFs hold assets in excess of €500 billion invested in banks, corporate and government debt (Source: IMMFA, November 2015). If this funding is diverted into deposits and other assets, it will have an immediate impact on funding and liquidity in the real economy with these issuers left to seek an alternative source of financing at a time of unprecedented financing constraints across Europe. The EU cannot afford to take chances with MMFR which would jeopardise the CMU project before it has even got off the ground. According to data from the IMMFA, several financial institutions, corporates, semi-state enterprises, public utilities, transport and infrastructural providers across the EU are relying on CNAV MMF investment.

Effects of US MMF reform on European funding

The importance of achieving an appropriate outcome on MMFR is further underscored by the impact of developments in the US where CNAV exemptions have been provided for MMFs that limit their investments to US Government securities and MMFs that exclusively have a retail investor base. The new rules will be implemented in October 2016 and have already had a profound impact, with a number of high profile announcements of managers moving to the US Government CNAV and condensing their offerings (See attached paper from Crane Data entitled "Effects of SEC Money Fund Reforms Already Being Felt"). A December report by Morgan Stanley Research indicates that 100% of the $1.4 trillion in assets currently held in US prime MMFs will migrate to government MMFs by October 2016 ('Asset Managers & Banks: Liquidity Conundrum in Practice: What's the Impact?', Morgan Stanley Research, 14 December 2015).

The move into US Treasuries and consequently out of European holdings will significantly impact on European issuers. European holdings by US prime CNAVs have regularly amounted to between $600 and $750 billion, with $658 most recently recorded in Nov 2015 (Source: Crane Data, November 2015). Significant beneficiaries of this investment include France ($262 billion), Sweden ($101 billion), the UK ($86 billion), the Netherlands (€60 billion), Germany ($41 billion), Switzerland ($56 billion), Norway ($35 billion), Belgium ($12 billion), Denmark ($3 billion) and Spain ($1 billion).

The Investment Company Institute (ICI) in the US estimates that roughly $300-400 billion worth of assets has already moved out of US prime institutional MMFs. Data on US prime institutional MMFs shows that historically 40% of these funds' assets were invested in European holdings, which means that already Europe has lost up to $160 billion in funding (Crane Data, November 2015).

Reference material to be uploaded:

'Effects of SEC Money Fund Reforms Already Being Felt', Crane, December 2015.

Suggestions to remedy the issue(s) raised

While we have numerous comments on the MMFR proposals and are seeking various technical clarifications, at a minimum, an appropriate outcome on MMFR for CNAV MMFs needs to address the following:

- Removal of the sunset clause on LVNAV MMFs. As the LVNAV is designed to be the successor vehicle to CNAV it should not be viewed as a transitional arrangement.

- Removal of the requirement for EU Public Debt CNAVs to invest 80% of assets in EU public debt by 2020. This restriction will result in no material take-up of the product – the Public Debt CNAV exemption should not be limited to EU government securities. For international trading purposes the

Public Debt MMF needs to allow for funds denominated in other major trading currencies and USD in particular.

- The permitted level of volatility for an LVNAV MMF must be maintained at a level of at least 20bps.
- The imposition of liquidity fees and redemption gates should be voluntary and not mandatory for a Retail CNAV MMF and a Public Debt CNAV MMF.
- The definition of “retail” for the purposes of a Retail CNAV MMF is too narrow and needs to be expanded to include any account for which the ultimate beneficial owner is a natural person (i.e. pension funds).
- The proposed transition period of 9 months is unrealistic and needs to be extended to a minimum of 2 years given the changes envisaged.

Example 2

Promoting a pan-European framework for loan originating AIFs and removing barriers to non-bank lending across Europe

Legislation

AIFMD

CRD

Summary of issue

The single-most important goal of the CMU project is to provide greater alternatives to bank lending, on which it is acknowledged the EU has an over-dependence. Loan funds provide one such alternative mechanism of SME financing and should therefore form a key part of CMU. We welcome the acknowledgement of loan funds in the Commission’s CMU Action Plan and urge the Commission, in coordination with ESAs and the Member States, to take forward proposals for developing a coordinated approach to loan origination in the EU. This is necessary for two reasons:

1. Firstly, an uneven playing field exists across the EU with respect to loan origination at present.
2. Secondly, barriers exist in various Member States when loan funds seek to deploy lending on a cross-border basis.

The rationale for EU-wide action is therefore very strong and necessary under the objectives of CMU to develop the environment for non-bank financing across Europe.

Supporting relevant and verifiable empirical evidence

Currently, some Member States permit loan origination but subject to greatly varying conditions. Other Member States do not permit loan origination at all, but increasingly individual Member States have been taking action in the area of loan origination and devising their own regimes (e.g. Ireland, Germany and Italy). In order to develop cross-border loan origination, prevent regulatory arbitrage and ensure investors are subject to equal levels of investor protection, it is necessary to have common standards for loan origination across the EU.

In a report on "Trends, Risk and Vulnerabilities" (No. 1 2015), ESMA highlighted loan origination as a focus area. The report highlights the recent and rapid growth in both loan participation and loan origination funds and noted that "this fledgling activity should develop within a harmonised EU framework that has appropriate risk mitigants in place". We welcome the prospect of an EU harmonisation initiative to ensure an appropriate level of regulation of loan origination across the EU in order to effectively mitigate risk and also to ensure a level playing field between Member States. However, we would also caution against the systemic risk oversight or supervisory authorities imposing constraints that would stifle this growing activity, as this would go against the policy objectives of CMU. It is important to strike an appropriate balance when regulating loan origination, as has been borne out in the Irish experience.

While a common set of rules and requirements for investment funds undertaking loan origination is clearly necessary, this alone will not address the issues loan funds operating cross-border face in seeking to deploy lending in Member States. This is, to a great extent, the result of the cumulative impact of the patchwork of national rules in place – not just the fact that specific regimes for these types of funds only exist in some countries, but critically the lack of recognition (and associated protections) of non-bank lending in national legal frameworks.

Some of the barriers that will need to be addressed in order to provide a level playing field between bank and non-bank (such as loan origination funds) lenders include:

- Access to information on national credit registers regarding the credit history of potential investee companies
- Lack of standardised procedures for taking security, enforcement and for creating loans/bonds, in particular, equivalent standards for European company registers for registering and enforcing pledges and similar charges
- Different treatment of bank loans and bonds in bankruptcies
- Regulatory barriers to lending (as distinct from deposit taking) such as the need for banking licenses etc. by allowing other regulated institutional investors or vehicles to lend
- Misalignment of tax incentives at national level including:
    - Withholding and transaction taxes on lending/interest, at least within the EU
    - Legislative preference given to banks, for example in taking security (stamp duties etc.) and transaction taxes

Suggestions to remedy the issue(s) raised

We propose that ESMA develop and consult on proposals for a common set of EU guidelines on loan origination funds. We suggest that ESMA guidelines would be a more expedient and effective way of achieving the goal of a harmonised EU framework for loan origination rather than a legislative proposal and a further AIF product at European level. Member States can then make the necessary amendments to their legislation and/or adjustments to national supervisory requirements and practices to align with the ESMA guidelines in the way is best adapted to their local regimes.

A further key exercise which would need to be driven by the Commission in coordination with the ESAs and the Member States will be to identify and address barriers to lending in individual Member States. In order to surmount these barriers, some of our members have suggested the creation of an EU-wide 'asset passport' that would give qualified funds (certain AIFs, including ELTIF, EuVECA and EuSEF) the right as an approved lender to deploy capital cross-border on an equal footing with banks. This would, in effect, address these barriers in a product-specific way, and would be a complement to any potential future harmonisation of specific rules for European funds originating loans under ESMA guidelines.

Many of the target investee companies are so-called 'mid-market' companies. However, there is no clear definition in European legislation of what constitutes a mid-market company which is likely to benefit most from non-banking lending. We recommend introducing a more targeted definition of a mid-market company than the existing SME definition, which is too restrictive. Rapidly expanding companies can quickly exceed the SME definition and still being too small for listing, it is important that these companies are not cut off from investment due to overly restrictive criteria.

Example 3

Financial penalties and constraints placed on investment funds by interest and dividend withholding tax legislation in each EU Member State, and the ability of CIVs to access double tax treaties to help reduce such taxes

Legislation

Interest and dividend withholding tax legislation in each EU Member State

OECD/G20 Base Erosion and Profit Shifting project and Action 6: 2015 Final Report – Preventing the granting of treaty benefits in inappropriate circumstances

Summary of issue

Withholding taxes arising on cross border interest payments from debt finance are a key tax barrier to SMEs accessing non-bank debt finance. Within the EU, only approximately half the Member States exempt cross-border interest payments (made outside the Interest and Royalties Directive) on both listed and unlisted debt.

Similarly, the domestic rates of withholding tax on cross border dividend payments can make it difficult for SMEs to raise equity finance, particularly where such finance is being sought from non-traditional sources.

CIVs in particular often suffer withholding taxes on the receipt of interest and dividends from other EU Member States which either 1) represent a real cost to the CIV or 2) require an often lengthy refund application process via the tax authority in the relevant Member State.

The OECD's Base Erosion and Profit Shifting ("**BEPS**") initiative

The ability to access double tax treaties (which will typically provide for a reduced rate of withholding tax on interest and dividend payments) is critical in enabling CIVs to reduce the real cost associated with withholding taxes.

The OECD's BEPS initiative – which is aimed at curbing double non-taxation by multinational companies – may, as an unintended consequence, run counter to the EU's CMU agenda by making it more difficult for many investment funds to access double tax treaties and operate on a cross-border basis in Europe.

In particular, the final recommendations in Action 6 of the OECD's BEPS project could lead to a limitation of treaty benefits for cross-border investment funds which would promote a fragmentation of investment funds along domestic lines, which runs contrary to the objectives of CMU.

However, we welcome the European Commission's recommendations on the implementation of measures against treaty abuse released on 28 January 2016. In particular, the proposal that EU Member States adopt only the general anti-avoidance Principal Purpose Test ("**PPT**") with the modification to allow for "genuine economic activity" is an important step, and should help ensure that those who do carry on a genuine economic activity in a particular jurisdiction are not unintentionally denied access to double tax treaties.

Notwithstanding this, we do note that the treatment of alternative investment funds or non-CIVs (which will be essential for the CMU to deliver investment in "real assets" such as infrastructure, venture capital or real estate), was not completed as part of the OECD's Action 6 final report. As such there is still no clear framework or plan which would enable such entities to claim treaty benefits. The absence of treaty benefits for non-CIVs would create a significant barrier to the ability of such entities to be an active part of the CMU.

Supporting relevant and verifiable empirical evidence

Dividend Withholding Tax

Across EU Member States the statutory rates of withholding tax on cross-border dividend payments vary from 0% (e.g. Hungary and the UK) to a 30% rate (e.g. Sweden and France). Therefore, depending on the market of investment, withholding tax and the ability to access the benefits and entitlement of double tax treaties is a key issue for cross border investment. For example, taking a benchmark dividend yield of approximately 3.4% (a European equity index), the annual withholding tax cost for a higher rate country (e.g. a 30% rate of withholding tax) would represent 102 basis points of the investment portfolio. In such situations, access to the entitlements of double tax treaties is critical as it would reduce the withholding tax cost by 51 basis points (using a standard treaty rate of 15% on portfolio investments).

Interest Withholding Tax

The majority of EU Member States provide for an exemption from withholding taxes on listed/registered corporate debt (e.g. quoted Eurobonds). There is one exception to this where a 20% rate of withholding tax is applied in Poland on all corporate bonds. However, there is a large variance on the application of withholding taxes across the EU to cross border interest payments on unlisted corporate debt. The rate of withholding tax ranges from a high rate of 27% in Belgium to a 0% rate of withholding tax in certain Member States (e.g. the Netherlands, Spain, Sweden).

Reference material to be uploaded: Statutory rates of withholding tax on dividends (ignoring any specific domestic exemptions that may be available) and interest payments on corporate debt, across the EU Member States.

Suggestions to remedy the issue(s) raised

While there are a number of local domestic exemptions from withholding taxes in various EU Member States, EU action on eliminating withholding tax has, to date, been largely restricted to intra-group payments.

As such, in order to avoid an uneven channelling of finance to SMEs within the EU and to reduce the borrowing costs for such SMEs, withholding taxes on interest payments on debt (both listed and unlisted) should be abolished across the EU. In addition, the domestic rates of withholding tax on cross-border dividend payments should be set to a minimum (either exempt or to a minimum rate equivalent to treaty rate) in order to encourage the development of key products such as ELTIFs, EuVECA etc.

Such a change would help bring the EU treatment of the taxation of such payments closer in line with the treatment adopted in the US.

We would also encourage the European Commission to provide further clarity on the entitlement of EU resident CIVs to treaty benefits. In light of the European Commission's recommendation in relation to the adoption of the PPT with a modification for "genuine economic activity", the European Commission and each individual Member State should acknowledge that a CIV which is regulated in the EU carries on a "genuine economic activity", and should therefore be automatically treated as having passed the PPT.

In the case of non-CIVs, the development of a tax framework for alternative investment funds is essential – this must deliver tax certainty for all parties (both investors and tax authorities) without creating tax avoidance opportunities that would be incompatible with BEPS. As acknowledged in the final report on Action 6, the OECD needs to work with the relevant industry stakeholders as early as possible in 2016 to explore solutions in relation to the entitlement of non-CIV funds to access tax treaties.

Example 4

Consequences of a common EU Financial Transactions Tax

Legislation

Proposal

Summary of issue

The introduction of a common EU Financial Transactions Tax ("**FTT**") which taxes instruments and intermediaries critical to CMU (such as investment funds) has the potential to create a significant barrier to the success of CMU.

If the transfer of units or shares in investment funds is subject to FTT, this would increase the cost to investors arising from investing in investment funds and, as a consequence, adversely impact on the return which investors derive from their investment. This would diminish one of the key benefits of investment funds, i.e. providing cost effective access to capital market investments to a wide range of investors, and would negatively impact on the ability of investment funds to act as one of the key providers of finance under CMU.

Supporting relevant and verifiable empirical evidence

A number of studies have been undertaken to examine the potential impact of an FTT on different stakeholders within the EU. These studies have shown that the introduction of an FTT would create additional costs to investors and reduce the value of household savings, while potentially creating only minimal additional tax revenues for EU Member States. In particular, the studies have shown that:

- The sale and purchase of a debt security liable for the tax would be charged at multiple stages of the chain of settlement, creating a "cascade effect" such that the effective tax rate would be in the order of 100 bps (or 1%) rather than 10bps. This would cripple activity on debt securities markets.
- The impact of the FTT on household savings is expected to be large in some Member States. In countries that plan to introduce the tax for example, the impact is in the order of €80bn (Spain) to €205bn (Italy), representing a loss of up to 16% of the value of the assets being taxed.
- In the case of Ireland, the introduction of an FTT would likely result in only a modest net tax revenue gain and may lead to certain firms choosing to leave Ireland in response to the introduction of the tax. Such a loss would lead to a reduction in financial sector output, employment and existing corporation tax revenue.

Reference material to be uploaded:

'The EU Financial Transactions Tax Proposal: A Preliminary Evaluation', Central Bank of Ireland and ESRI, April 2012

'The impact of a Financial Transaction Tax on Corporate and Sovereign Debt', International Regulatory Strategy Group and the City of London, April 2013

'The effect of a Financial Transaction Tax on European Households' Savings', International Regulatory Strategy Group and the City of London, February 2014

Suggestions to remedy the issue(s) raised

As part of the implementation of CMU, strong consideration should be given to the abolition of the FTT across all EU Member States.

Failure to do so would negatively impact on one of the key drivers behind CMU being "to ensure greater diversification in the funding of the economy and reduce the cost of raising capital, particularly for SMEs".

Example 5

Narrow definition of professional investor under AIFMD/MiFID and resulting constraints on financing and the attractiveness of products such as ELTIF

Legislation

AIFMD

MiFID

ELTIF Regulation

Prospectus Directive

Summary of issue

CMU has the objective of encouraging long-term investment in the European economy via products such as ELTIF. However, the definition of professional investor under Article 4.1(ag) (which links to Annex II of MiFID II) is too restrictive to allow investment by certain classes of investors for whom the profile of the investments would be appropriate. In particular, entities such as foundations, charities, national providers of pension schemes, church organisations or family offices which generally favour long-term engagements are in most cases deprived of the possibility to obtain the professional investor status and thus not able to exploit investment opportunities available to professional investors. EuVECA/EuSEF recognise the importance of enabling such investment by permitting another category of investor who can commit a minimum of €100,000 and provide a self-certification to be treated as professional. However, this is not the case with regard to ELTIF or AIFMD generally.

In the case of ELTIFs, such investors looking for more long-term investment opportunities have the potential to become key players and contributors for the success of this new vehicle. However, it is highly unlikely that these types of "semi-professional" investors would meet the requirements of MiFID to be treated as professional (minimum portfolio of more than € 500,000 and especially the requirement of trades with an average frequency of 10 per quarter over the previous four quarters).

In recognition of this, some Member States (e.g. Germany and Luxembourg) have introduced a "semi-professional" category of investor who typically is required to invest a minimum of €100,000 and provide an attestation that they wish to be treated as professional.

However, under the current European framework, such investors classified as "semi-professional" at Member State level are not eligible to benefit from the AIFMD passport (which applies only to professional investors meeting the MiFID definition) and to choose from an EU-wide range of suitable investment opportunities e.g. those focusing on infrastructure or SME financing which are mainly set up for professional investors. Furthermore, non-retail AIFs admitting "semi-professional" investors under national law have to struggle with additional burdens such as the application of the PRIIPs regime and the requirement to produce a PRIIPs KID.

Supporting relevant and verifiable empirical evidence

According to EFAMA, total AuM in Europe in 2014 (inclusive of investment funds and discretionary mandates) amounted to an estimated EUR 19 trillion (Source: 'Asset Management in Europe', EFAMA, April 2015). Discretionary mandate assets at the end of 2014 are estimated at €9.9 trillion or 52% of AuM, whereas investment funds accounted for the remaining €9.1 trillion or 48%. Typically, asset managers receive mandates from institutional clients and high-net-worth individuals, whereas investment funds serve both retail and institutional clients' investment needs. Pure retail investment accounts the smaller share of this investment at 26%, with a diverse group of institutional clients accounting for the largest share of 74% of AuM. Insurance companies and pension funds, acting on behalf of millions of households, accounted for 39% and 33% of total institutional AuM, respectively.

A further segment of "other institutionals" (exclusive of banks, insurance companies and pension funds) accounted for 25% of the institutional mandate. In other words, there is an existing market comprising of "other institutional investors" (e.g. foundations, charities, high net worth individuals, church organisations, family offices, university endowments, etc.) across Europe valued at €3.5 trillion in AuM. This figure does not include the additional €4.6 trillion held in pension fund investments assets across Europe. These statistics from EFAMA point to a very sizeable market in Europe which could be classified as "semi-professional" and with a longer-term investment profile.

Suggestions to remedy the issue(s) raised

The introduction of a new EU category of "semi-professional investor" within AIFMD or ultimately under the MiFID framework could broaden the professional investor base and further diversify the supply of funding to long-term projects in the EU. In our view, such new investor category should be modelled along the lines of EuSEF/EuVECA Regulations which inter alia impose a minimum investment amount for investments by other investors than professional investors.

Furthermore, the newly expanded definition of "professional investor" should be consistent with the "qualified investor" definition under the Prospectus Directive and the Prospectus Directive should be amended to refer to the professional investor definition in MIFID.

Issue 2 – Market liquidity

Please specify whether, and to what extent, the regulatory framework has had any major positive or negative impacts on market liquidity. Please elaborate on the relative significance of such impact in comparison with the impact caused by macroeconomic or other underlying factors.

Example 1

The impact of regulatory reform on secondary market liquidity, particularly in the corporate bond markets

Legislation

N/A

Summary of issue

One area highlighted by our members is the impact of regulatory reform on secondary market liquidity, particularly in the corporate bond markets.

Market liquidity – that is, a market's ability to facilitate purchase or sale of an asset without causing a change in that asset's price – is of critical importance to all investors, and to the proper economic functioning of markets overall.

The reason for the lower levels of liquidity in corporate bond markets are manifold, and only partly a result of regulation. We see the macroeconomic environment – in which low interest rates have been a key feature in most developed countries – coupled with investor appetite for these assets, as having ushered in a significant wave of primary issuance in recent years. This has fragmented liquidity amongst an ever-greater number of issues.

In parallel, the market has undergone important architectural changes as a result of the combined effect of bank regulation. Where once the market was a largely principal market (that is, with banks acting as market makers), the regulatory pressures on market making – from increased capital charges on banks' trading books, to direct constraints under structural reforms like the Volcker Rule in the US, and corresponding EU (BSR) and national rules (e.g. in the UK, France and Germany) – and broader economic factors triggering de-leveraging by the banks, have meant greatly reduced inventories held by banks. This has caused a structural shift more towards an agency market, with the buyer or seller taking on full execution risk – that is, the risk that a trade will not be executed at the expected price.

While this is potentially a natural evolution (for example, equity markets operate largely under an agency model), it has an impact on forward policymaking, and the calibration of existing rules. With end users bearing execution risk, the need for market liquidity becomes more important. We are encouraged that the European Commission has committed to looking at liquidity in corporate bond markets as part of the CMU agenda and would encourage them to investigate whether there are potential steps to encourage primary issuance practices that can increase liquidity.

Supporting relevant and verifiable empirical evidence

Reference material to be uploaded: 'Global Financial Markets Liquidity Study', PwC, August 2015; 'Addressing Market Liquidity', BlackRock, July 2015

Suggestions to remedy the issue(s) raised

In the near term, we would also urge that the calibration of the MiFID II/ MiFIR trading rules, and the upcoming CSDR rule making on settlement discipline are seen through the lens of the evolution of the market, and at least do no further harm to market liquidity.

Issue 3 – Investor and consumer protection

Please specify whether, and to what extent, the regulatory framework has had any major positive or negative impacts on investor and consumer protection and confidence.

Example 1

The "Member State of reference" concept which would apply if a third country passport is granted under AIFMD and the negative investor protection implications

Legislation

AIFMD

Summary of issue

"Member State of reference" is defined under Articles 4(1)(z) and 37(4) of AIFMD, and is applied in the depositary context under Article 21(5)(b) of AIFMD.

In the event that the AIFMD passport is extended to AIFMs and AIFs located in one or more non-EEA ("**third country**") jurisdictions, AIFs in those jurisdictions could be marketed on a passport basis across the EEA subject to full compliance with AIFMD, including in particular the requirement to appoint a depositary.

In that scenario, Article 21(5)(b) of AIFMD would require the depositary of the third country AIF to be established either

(i) in the "Member State of reference" of the AIFM (for AIFs managed by third country AIFMs);
(ii) in the home Member State of the AIFM (for third country AIFs managed by EEA AIFMs); or
(iii) in the home jurisdiction of the third country AIF.

This prescriptive requirement regarding depositary location has the unintended consequence of potentially reducing investor protection and financial stability and creating unnecessary market disruption. This is due to the complexities and uncertainties arising from the selection of the Member State of reference, which make it likely that the depositary of a non-EU AIF being marketed by a non-EU AIFM under the third country passport will be located outside of the EU.

Supporting relevant and verifiable empirical evidence

We believe that the requirement regarding depositary location in the context of the third country passport creates the potential for uncertainty, confusion and unnecessary risk to investors for the following reasons:

<u>The "Member State of reference" of the AIFM is subject to change and uncertainty.</u>

The process in Article 37(4) of AIFMD by which the "Member State of reference" ("**MSoR**") is determined is complex, particularly where distribution of the relevant third country AIF is envisaged in several Member States, because no single deciding factor is provided. Instead regulators must come to a mutual agreement and in the absence of such agreement, ESMA will arbitrate the decision. The MSoR can also change over time, subject to distribution and management activities in the EU.

As a result, the MSoR concept does not provide a reliable long-term basis for the selection of a depositary, because if the location of the MSoR was to change, this could trigger a requirement for a third country AIF to appoint a depositary in another country. Changing a depositary is a significant, costly and time-consuming project, so many AIFMs would wish to avoid that possibility and would therefore be reluctant to appoint a depositary based on the current location of the MSoR.

<u>The home jurisdiction of the third country AIF may not offer a choice of suitable depositaries</u>.

As currently drafted, the only remaining option for a non-EU AIFM managing a non-EU AIF would be to appoint a depositary in the home country of the AIF. In most cases, this would result in the depositary being appointed in lighter regulatory regimes which are unfamiliar with AIFMD and other EU requirements. This is not optimal from an investor protection perspective, as very few non-EU jurisdictions have a developed depositary business with the specialised expertise, infrastructure, resources and capacity to carry out depositary duties to AIFMD standards.

Many AIFMs already marketing in the EU will be forced to dismantle existing depositary arrangements incurring significant investor cost.

EEA AIFMs marketing third country AIFs in the EEA are already obliged to appoint depositaries pursuant to Article 36 of AIFMD. In addition, the national private placement regimes of certain Member States require all AIFs marketed in those countries to have appointed depositaries. As there is no equivalent geographical restriction akin to Article 21(5)(b), many of those third country AIFs have appointed depositaries in the existing EU centres of depositary expertise. If the third country passport was to be implemented, many of those AIFs may be forced to unbundle existing depositary arrangements which have only recently been agreed, creating the unintended consequences of (i) additional costs in replacing depositary; and (ii) potentially reducing investor protection if, as a result of the factors above and the inflexibility of Article 21(5)(b), a depositary in a centre of expertise in the EU is replaced with a depositary in the third country domicile of the AIF.

In conclusion, Article 21(5)(b) as currently drafted will limit the choice of AIFMs to appoint the most appropriate and qualified depositary to third country AIFs. It is likely that for many such AIFs, the depositary would be appointed in the third country domicile of the AIF, irrespective of whether that third country contains depositaries of sufficient expertise and experience to carry out the very specific and onerous depositary obligations of AIFMD. There is also likely to be a flow of existing depositary business out of the EU and into the same third country centres. This runs counter to the objectives in the Call for Evidence of (i) promoting economic and financial stability in the EU; and (ii) ensuring a high level of investor protection.

Suggestions to remedy the issue(s) raised

The investor protection concerns identified above could be resolved by introducing the flexibility for third country AIFs, as a fourth alternative to the three options already set out in Article 21(5)(b), to appoint a depositary located in any Member State provided that it meets the depositary eligibility criteria of Article 21(3). Ideally, this would entail a change to the Level 1 text of Article 21(5)(b), but there could also be scope for taking a broader interpretation of the "Member State of reference" criteria of Article 37(4) to achieve the same outcome.

Example 2

Treatment by MiFID II of all AIFs as complex

Legislation

MiFID II

Summary of issue

The MiFID regime classifies certain products as complex in order to prohibit their sale by way of execution-only. In its technical advice of December 2014, ESMA treats all AIFs as complex products. This is disproportionate and inaccurate.

Supporting relevant and verifiable empirical evidence

This ignores the fact that many Member States have long-established regulatory frameworks for retail alternative investment funds that are specifically designed for retail customers. In many instances, these funds are subject to detailed requirements over and above those set out under AIFMD, and are in many respects similar to those imposed on UCITS. It is illogical to disregard whole product categories from being treated as non-complex financial products and it should be possible to assess the complexity of each product for the purpose of determining whether it can be distributed by execution only.

Suggestions to remedy the issue(s) raised

Whole product categories as broad as all AIFs should not be excluded from being treated as non-complex financial products. Instead, it should be possible to assess the complexity of each product for the purpose of determining whether it is suitable for distribution by execution only.

Issue 4 – Proportionality / preserving diversity in the EU financial sector

Are EU rules adequately suited to the diversity of financial institutions in the EU? Are these rules adapted to the emergence of new business models and the participation of nonfinancial actors in the market place? Is further adaptation needed and justified from a risk perspective? If so, which, and how?

Example 1

Mismatch between EU rules on investing in securitisations under AIFMD and the US framework on securitisations

Legislation

AIFMD

Summary of issue

Under Article 17 of AIFMD, AIFMs may only assume exposure to securitisations on behalf of AIFs if the originator, sponsor or original lender retains a material net economic interest in the securitisation of not less than 5% (the "**EU retention requirement**"). Article 17 currently only applies to EU authorised AIFMs. It does not apply to non-EU AIFMs.

In circumstances where an AIF invests in US securitisations, these securitisations are not subject to the risk retention regime introduced under the EU Capital Requirements Directive of 31 December 2010 and so most will not be compliant with the EU retention requirement.

The final US rules in relation to these securitisations ("**US retention requirements**") were published in October 2014. They have many similarities with the EU regime (most importantly, there is a 5% risk retention) but there are some important differences:

- the US rules will not be effective until late 2016, with all prior securitisations grandfathered; and
- the rules apply to the "sponsor" of the securitisation and the sponsor does not have to be a MiFID-regulated firm (as required under the EU retention rules).

Accordingly, it is considered unlikely that an investment portfolio comprised of US securitisations would ever be in a position to be fully compliant with the EU retention requirement.

Supporting relevant and verifiable empirical evidence

The restriction outlined above effectively shuts off the ability of AIFs within the EU from getting investment exposure to US securitisations and is therefore disproportionate, reduces diversification and concentrates risk in solely European securitisations.

This limits investor choice and diversity of investment options under AIFMD. It may deter managers and investors from participating in AIFs subject to the overall protection of AIFMD whereby instead they seek to get exposure to US securitisations through vehicles outside the scope of AIFMD.

Suggestions to remedy the issue(s) raised

We suggest that Article 17 of AIFMD and the related AIFMD Level 2 Regulation be amended to provide that securitisations compliant with the US retention requirements are also eligible investments for AIFs managed by AIFMs.

Issue 5 – Excessive compliance costs and complexity

In response to some of the practices seen in the run-up to the crisis, EU rules have necessarily become more prescriptive. This will help to ensure that firms are held to account, but it can also increase costs and complexity, and weaken a sense of individual responsibility. Please identify and justify such burdens that, in your view, do not meet the objectives set out above efficiently and effectively. Please provide quantitative estimates to support your assessment and distinguish between direct and indirect impacts, and between one-off and recurring costs. Please identify areas where they could be simplified, to achieve more efficiently the intended regulatory objective.

Example 1

Finding information on and meeting individual Member State marketing and disclosure requirements

Legislation

UCITS

Summary of issue

Article 91(3) of the UCITS Directive states that "*Member States shall ensure that complete information on the laws, regulations and administrative provisions which do not fall within the field governed by this Directive and which are specifically relevant to the arrangements made for the marketing of units of UCITS, established in another Member State within their territories, is easily accessible from a distance and by electronic means. Member States shall ensure that that information is available in a language customary in the sphere of international finance, is provided in a clear and unambiguous manner and is kept up to date.*"

The above requirements can often be difficult to locate on certain individual local Member State's regulatory authority website(s), furthermore requirements can be unclear or in some cases the latest not available in English.

Supporting relevant and verifiable empirical evidence

Examples of these occurrences include (but are not limited to) Belgium, France, Greece, Italy, Spain and Portugal. Belgium in particular is very slow to make its latest requirements available in English.

With regard to the additional investor disclosures required under German rules for local investors, BaFin requires that "*The prospectus intended for marketing in the Federal Republic of Germany must contain a page-numbered information section for investors in Germany that is an integral part of the prospectus and is listed in the table of contents...*" meaning that it is not possible to supplement the home state approved prospectus to reflect the additional German investor disclosures but rather the (home state approved) prospectus must be modified, resulting in an additional compliance burden and costs for managers.

Furthermore, with regard to marketing materials (i.e. those outside of the prospectus, KIID etc.), certain Member States, including Belgium and France, require these be drawn up in accordance with local laws and filed and/or approved before use. While this is not contrary to the UCITS Directive, it could be construed as an impediment for a UCITS to freely market its units in another Member State as contemplated under Art. 93(3) whereby it may "…*access the market of the UCITS host Member State as from the date of that notification*" being that date of receipt of confirmation from its home Member State that it has transmitted the notification letter.

Suggestions to remedy the issue(s) raised

We would recommend that ESMA retain a central repository of each Member State's requirements with a link to the relevant section of each Member State regulator's website. Greater clarity and visibility in relation to individual Member State rules regarding specific marketing materials would significantly enhance efficiencies.

Noting BaFin's specific investor disclosure requirements outlined above, a supplement (or annex) to the prospectus should in fact fulfil the obligation whereby such information "is an integral part of the prospectus" provided such supplement (or annex) is clear that any such supplement (or annex) forms part of and should be read in conjunction with the prospectus. The additional gold-plating whereby the table of contents in the home state approved prospectus be amended to include reference to any such disclosures goes beyond the intention of the Directive. It is worth noting that while a number of Member States do impose additional local investor disclosures (accompanying the prospectus) when distributing to local investors, no other Member State imposes this extent of gold-plating. In the context of Irish authorised UCITS, any modifications to the home state approved prospectus (such as those triggered by the BaFin requirements) must be filed with and noted by the Central Bank of Ireland prior to their use. It is recommended that German requirements are closer aligned with those of other Member States thereby removing the requirement for amendment to the home state approved prospectus.

Example 2

Response timeframes by National Competent Authorities

Legislation

UCITS

Summary of issue

The UCITS Directive provides "*Upon the transmission of the documentation, the competent authorities of the UCITS home Member State shall immediately notify the UCITS about the transmission. The UCITS may access the market of the UCITS host Member State as from the date of that notification.*" (Ref Art. 93(3)).

Furthermore, Article 5(1) of Commission Regulation (EU) N. 584/2010 states that "*When the competent authorities of a Member State in which a UCITS proposes to market its units receive the documentation to be transmitted to them pursuant to Article 93(3) of Directive 2009/65/EC, they shall confirm to the competent authorities of the UCITS home Member State as soon as possible, but no later than five working days from the date of the receipt of such documentation whether or not:…*"

There are different interpretations of the interaction between the 10 business day notification period and the 5 business day period within which host regulators can raise any comments/queries. The UCITS Directive provides that firms can market upon receipt of confirmation that the cross-border notification has been transmitted, however, it is not clear how this interacts with the 5 business day period allowed for host regulators to raise comments/queries and whether firms are entitled to market after 10 business days notwithstanding the fact that a query or comment has been raised by the host regulator. Furthermore, response timeframes can also be inconsistent.

Supporting relevant and verifiable empirical evidence

A direct consequence of the above is that until any such issue/question has been addressed to the host state authority's satisfaction, the UCITS will not be entered on the register of foreign UCITS approved for marketing. Certain categories of institutional/professional investors in particular require categorical evidence of entry of the foreign UCITS onto the local host state register before they can subscribe. Consequently, any delays in this process can have a direct economic impact for the capital raising of the UCITS.

Suggestions to remedy the issue(s) raised

It is recommended that ESMA provider greater clarification in relation to marketing approval timeframes to include improved regulatory evidence of ability to market following confirmation of transmission home state.

Example 3

Local Member State regulator notification obligations in respect of updates to documentation

Legislation

UCITS

Summary of issue

Article 93(7) of the UCITS Directive provides that "*The UCITS home Member State shall ensure that the competent authorities of the UCITS host Member State have access, by electronic means, to the documents referred to in paragraph 2 and, if applicable, to any translations thereof. It shall ensure that the UCITS keeps those documents and translations up to date. The UCITS shall notify any amendments to the documents referred to in paragraph 2 to the competent authorities of the UCITS host Member State and shall indicate where those documents can be obtained electronically.*"

Furthermore, Article 93(8) of the UCITS Directive provides that "*In the event of a change in the information regarding the arrangements made for marketing communicated in the notification letter in accordance with paragraph 1, or a change regarding share classes to be marketed, the UCITS shall give written notice thereof to the competent authorities of the host Member State before implementing the change*."

Supporting relevant and verifiable empirical evidence

The above requirements place a significant compliance and cost burden on cross-border UCITS that have received approval to market across various Member States, whereby the UCITS is obliged to notify each respective host state authority of routine updates to documents.

Suggestions to remedy the issue(s) raised

Noting the provisions of Art. 93(7) in particular, whereby home and host state authorities have access by electronic means to the latest fund documentation, this obligation would appear somewhat superfluous and outdated. We suggest electronic access is sufficient for the latest fund documentation and the obligation to notify changes to fund documentation and/or information that formed part of initial passport application, including changes regarding share classes to be marketed, fall to the home Member State authority.

Example 4

The ban on inducements and the ability of portfolio managers to obtain research from brokers or third parties

Legislation

MiFID II

Summary of issue

From a funds perspective, one of the most controversial aspects of MiFID II is its ban on independent investment advisers and portfolio managers retaining fees, commissions or any "*monetary or non-monetary benefits*" paid by a person other than their client in relation to the provision of services except for certain "*minor* *non-monetary benefits*". It is widely considered that this ban will significantly curtail or terminate the ability of portfolio managers to obtain research from brokers or third parties without having to pay for it.

In particular, ESMA is proposing a "full" unbundling of research payments so that a manager must either pay for research (a) out of its own pocket, or b) from a separate ring-fenced research payment account funded by a specific charge to its clients. In the event that a manager funds research from a research payment account, ESMA is also proposing that the manager be required to comply with a number of detailed requirements on the governance of the account and on spending.

Supporting relevant and verifiable empirical evidence

If a manager has to pay for its own research, this is likely to lead to a decline in the amount of research used, with a knock on impact on investment performance. It is also likely to result in a reduction in research on less liquid stocks and SMEs and a reduction in the research on lesser-performing sectors. Moreover, smaller asset managers will be placed at a disadvantage for obtaining the research they need to compete with larger incumbents.

Furthermore, because of the soft European economic climate and the fear that unbundling could disrupt access to the capital markets and stall job creation, regulatory arbitrage could arise from the national authorities adopting varying degrees of "relaxed" standards to avoid some of the fallout of the prohibition. In addition, EU managers will be potentially disadvantaged in competing with non-EU managers, who will not be bound by these restrictions.

While MiFID II is primarily concerned with investment firms managing individual portfolios of clients and does not apply to collective investment schemes, ESMA has proposed to the European Commission that the MiFID II approach should be carried across to both UCITS and to AIFs. Any such changes would extend the difficulties described above to all collective investment schemes.

Suggestions to remedy the issue(s) raised

Research should not be classified as an inducement for the purposes of MiFID II. The Commission should not amend the legislation applicable to collective investment schemes so as to prohibit the use of dealing commission to pay for research.

Example 5

Restrictions on the portfolio and eligible assets under the ELTIF Regulation

Legislation

ELTIF Regulation

Summary of issue

Chapter II of the ELTIF Regulation details specific provisions regarding the investment policies of ELTIFs. Certain of these rules could be further clarified or relaxed in the case of ELTIFs marketing solely to professional investors. We would highlight the following:

- Clarify the ability of ELTIFs to invest in loans on the secondary market as well as originate loans to qualifying portfolio undertakings.

- Allow greater flexibility in relation to asset diversification in the case of ELTIFs marketing solely to professional investors.

Supporting relevant and verifiable empirical evidence

ELTIFs are clearly permitted under Article 10(c) of the ELTIF Regulation to originate loans to eligible undertakings. The ability to buy or invest in loans on the secondary market is less clear. Since ELTIFs can originate their own loans, there is no reason why ELTIFs should not be permitted to invest in other high quality loans meeting the criteria for a qualifying portfolio undertaking under Article 11. The flexibility to invest in as well as originate loans forms a core part of the strategy of investment managers specialising in this area. We therefore encourage a clarification that investment in loans is permitted under the eligible investment rules for ELTIFs.

Due to the specialised and diverse nature of long term illiquid investment projects, investment managers need to be able to tailor investment policies appropriately to the specific project. Some investment policies may have a higher concentration of assets than would be permitted under ELTIFs and others may even be single asset funds. Many infrastructure investment policies tend to be highly concentrated, e.g. investment in wind turbines or a single large scale project such as the Eurotunnel, forestries etc. For professional investors, who are willing to take on more risk and a higher concentration of assets in order to achieve a greater return, it makes sense to provide more generous diversification rules than 10% per asset.

Suggestions to remedy the issue(s) raised

Article 10(c) should be clarified to permit loans acquired on the secondary market by the ELTIF which meet the conditions of Article 11 in relation to the qualifying portfolio undertaking.

Article 13.5 should clarify that by way of derogation from points (a) and (b) of paragraph 2, an ELTIF may raise the 10 % limit referred to therein to **25** %, where the ELTIF markets solely to professional investors.

Issue 6 – Reporting and disclosure obligations

The EU has put in place a range of rules designed to increase transparency and provide more information to regulators, investors and the public in general. The information contained in these requirements is necessary to improve oversight and confidence and will ultimately improve the functioning of markets. In some areas, however, the same or similar information may be required to be reported more than once, or requirements may result in information reported in a way which is not useful to provide effective oversight or added value for investors.

Example 1

The fragmented approach to regulatory reporting and the difficulties arising at implementation

Legislation

AIFMD, EMIR, MiFID II, SFT, MMFR proposal

Summary of issue

In response to the financial crisis the Commission issued a range of regulatory measures to monitor and manage systemic risk. An element of many of these measures is the requirement to report transaction level and fund level data to national competent authorities and trade repositories. The following EU regulatory regimes, both implemented and pending, require a significant amount of transaction level reporting:

- EMIR requires reporting to a trade repository of 85 data fields for any derivative contracts (either OTC or exchange-traded) and mandates that both counterparties to a transaction must report the same transaction.
- The MiFID II transaction reporting requirements have been extended considerably due to the increase in scope of instruments and trading venues in MiFID II and the expanded number of reporting fields.
- SFT imposes an obligation on both counterparties to an SFT to report details of the transaction to a trade repository within one working day of the transaction's conclusion, modification or termination.

In addition, AIFMD Annex IV reporting requires detailed and comprehensive reporting reporting of the investment profile, including exposure concentrations, instruments traded and individual exposures, risk, liquidity and leverage data. The draft Money Market Fund Regulation will also mandate further detailed portfolio level reporting for UCITS and AIFs run as MMFs.

The above reporting requirements are not consistent in relation to content, classifications, frequency, format and destination. The rules have largely been devised in a very siloed way, leading to a degree of incoherence between the various reporting frameworks. MiFID II and EMIR require reports to be made to regulatory or trade repositories on certain derivative transactions. While MiFID II envisages the possibility of relying on EMIR reports, this may not be workable due to differences at the level of the detailed requirements. There is a strong case for streamlining reporting obligations across existing financial services legislation with a view to achieving greater coherence and in order to limit the number of reports that ultimately need to be submitted to market participants.

The current approach to regulatory reporting results in managers having to develop multiple parallel costly reporting capabilities. Moreover, regulatory authorities do not receive this information in a single standardised format across all regulatory frameworks. In fact, oversight bodies such as the ESRB do not appear to have ease of access to all the reported data and are having to request information directly from fund managers, creating further inefficiencies. A more streamlined receipt of the data in a standardised way via a single regulatory reporting framework or portal would allow authorities to assess data with greater ease to monitor macroeconomic risks and also minimise the cost to individual regulators of having to build their own reporting systems to implement EU level requirements. While the build costs on an individual regulator basis may be more justifiable for some regulators, depending on the population of reporting entities within scope, in many cases regulators are required to develop systems at great expense for reporting by a very small number of entities, e.g. four AIFMs in Latvia versus 365 in the UK (Source: ESMA AIFM Register, January 2016).

Furthermore, the application of AIFMD reporting requirements across Member States is not fully harmonised, which means that managers operating across a number of European jurisdictions must provide their AIFMD reporting in multiple file formats to multiple local regulators before its ultimate transmission to ESMA by the national regulators. For AIFMs filing under National Private Placement Regimes as prescribed under Article 42, reporting must be submitted to the competent authority of each Member State in which the AIF is marketed, creating very significant duplication. For major asset managers operating cross-border the patchwork of AIFMD reporting requirements results in the filing of over forty reports to local regulators each quarter. This approach contrasts negatively with markets such as the United States where, although there are a number of supervisory bodies, reporting requirements are consistent across States and are not subject to 'gold plating' on a State by State basis. Furthermore, the AIFMD reporting requirements are just as complex as Form PF in the US, yet

AIFMs have half the time to complete the work under EU requirements compared with the US (30 days versus 60 days).

Significant differences between international standards on reporting in terms of classifications, thresholds and reportable data (e.g. EMIR versus Title VII of Dodd Frank, AIFMD Annex IV versus Form PF) create further compliance burdens, inefficiencies and barriers to entry for fund managers operating within and outside the EU. There is significant overlap between Form PF and AIFMD, but there are enough differences in individual definitions to force managers to have to undertake reporting analysis on the same fund multiple times even though the general nature of the reporting is similar. Greater international convergence would be extremely beneficial.

Unrealistically tight deadlines, delays in the detailed implementing measures and guidance and uncertainty over reporting deadlines upon implementation creates a challenging environment for managers seeking to plan their compliance. This occurred for example in relation to the roll-out of AIFMD Annex IV reporting following the late issue by the Commission of the final Level 2 in December 2012. A Commission Q&A released in March 2013 clarified that existing AIFMs were expected to start reporting as of the date of the application of the AIFMD, i.e. 22 July 2013. However, ESMA only finalised its reporting guidance in October 2013. Local regulators did not have sufficient time to meet the expectations of the Commission and subsequently clarified their own transitional arrangements and start dates. The reporting timeframes under EMIR provide a further example of condensed timeframes where trade repositories could not handle the volume of applications being received.

Also contributing to challenges and uncertainties is the hard-coding of certain detailed requirements and classifications under the Level 2 text, e.g. Annex IV reporting under AIFMD. This approach constrains ESMA in terms of the requirements and guidance it can issue from a practical perspective and makes it harder to update or amend requirements where issues arise or where reporting synergies could be achieved. Managers can consequently be left with reporting requirements that are difficult to interpret and apply in practice.

On top of the EU level reporting requirements, local regulators also impose their own investment funds reporting, for example the quarterly Money Market and Investment Funds (MMIF) Return required by the Central Bank of Ireland also add to and duplicate the compliance burden.

Ambiguity due to late or unclear guidance, continuous updates and changes to reporting requirements under the various regulatory frameworks and by the various supervisory authorities further compound the challenge and the resources required to be dedicated to regulatory reporting.

Supporting relevant and verifiable empirical evidence

The siloed and continually evolving approach to regulatory reporting described above creates a very significant burden on fund managers and their service providers from a cost and resources perspective. Most managers will not have the capacity to continuously track all the requirements and complete the reporting without external assistance although they will still have to spend time understanding and interpreting the rules, gathering and preparing the data for transmission and overseeing the process, with demands on the compliance, internal audit, portfolio management, risk management and fund administration functions. It is estimated that hiring an external consultant to undertake the reporting solely under AIFMD will cost in the region of €4,000 per fund (Source: 'How Regulation is Damaging Competition in Asset Management', The New City Initiative, December 2014). To this will be added further costs of reporting to trade repositories and local regulators on a myriad of other reporting requirements.

To illustrate the fragmentation under the global derivatives framework, national regulators operate around 22 repositories, collecting data from 11 jurisdictions, each with their own reporting requirements, formats and mandates (Source: Ibid). The total cost associated with the completion of various reports for a range of funds to meet EU and local requirements can easily run into hundreds of thousands or even millions of Euro per manager and individual fund managers will be able to provide evidence to support this.

While larger fund managers have been able to absorb the cost due to their scale, reporting obligations can be particularly prohibitive for smaller, specialist players and new start-ups and are contrary to the innovation and diversity in the financial sector that CMU seeks to promote. The number of boutique investment fund operations in the UK fell to 34 last year from 40 in 2013 due to regulatory cost which is stifling innovation, according to the Investment Association (Source: Financial Times, 11 October 2015). It is estimated that the overall number of asset managers in the UK has declined by about 20% since 2001 and the cost of complying with AIFMD is seen as a major driver of this consolidation with regulatory reporting among the most significant ongoing costs under that regime (Source: 'How Regulation is Damaging Competition in Asset Management', The New City Initiative, December 2014).

Reference material to be uploaded: 'How Regulation is Damaging Competition in Asset Management', The New City Initiative, December 2014

Suggestions to remedy the issue(s) raised

The challenges arising from the siloed nature of the EU's regulatory reporting regimes should be addressed though a more cohesive, integrated and streamlined approach to regulatory reporting. Ideally we would propose the development of a Common European Reporting Platform for securities/funds and fund managers that would be operated by ESMA to which all reporting entities submit their data and from which all regulators could obtain the information necessary for supervision, thereby creating efficiencies and cost savings and enabling more effective identification and management of cross-border risks. We recognise that this may take some time to develop and would encourage the Commission and ESMA to lay the groundwork for a Common European Reporting Platform through greater convergence and streamlining. Specifically we would recommend:

- Development of an integrated EU reporting strategy starting with a comprehensive review and analysis of all data and reporting requirements at European and Member State level with a view to eliminating duplication, streamlining requirements and availing of synergies
- Starting with a common European reporting portal for AIFMD Annex IV reports and rolling this approach out under MMFR reporting and other reporting not yet implemented
- Further standardisation led by ESMA of reporting guidance and instructions to cover methodologies, formats and clarifications/interpretations
- Devising the detailed reporting requirements and classifications at Level 3 under ESMA rather than hard-coding these under Level 2 legislation, which makes it very difficult to update the requirements to take account of issues arising
- Removal of the requirement under EMIR for both counterparties to report a transaction in order to avoid duplication of reporting
- Greater efforts at a global level to harmonise reporting requirements given the international nature of the financial services industry
- In this regard, basing reporting formats on the existing international standards and methodologies provides a strong basis for defining and structuring the data and opportunities for increasing automation and synergies
- Sufficient lead-in timeframes for new reporting and for the development of accompanying technical guidance

Example 2

Calculation, reporting and disclosure of leverage figures under the AIFMD

Legislation

AIFMD

Summary of issue

AIFMs disagree with the utilisation of only the gross and commitment approaches for calculating leverage (AIFMD Level 2, Articles 6 to 11) , as this is not reflective of market practices or a common understanding of the genuine level of leverage in a fund. These methodologies are consequently used solely for regulatory purposes and there is no perceived benefit to the risk management of the fund, given that they do not reflect how managers measure and manage leverage in the portfolio on a day-to-day basis. The application exclusively of the gross and commitment approaches often creates confusion among investors, who may mistake these higher reported figures for levels of leverage representative of a higher risk strategy.

AIFMs therefore have to invest significant time educating investors on the nature of the methodologies, in addition to the extra cost of making these calculations for regulatory purposes only. The intention of AIFMD is that the leverage figures are used by regulators to determine systemic risk but the calculations do not appear appropriate for that purpose. There does not seem to be any apparent recording of risk versus leverage in the methodologies prescribed. Furthermore, while AIFMs expend considerable time and resources in reporting these figures, it is not immediately apparent for what purpose or how this information is being used or interpreted.

Supporting relevant and verifiable empirical evidence

The gross methodology requires the addition of the absolute value of all the positions in the portfolio with no ability to offset positions that cancel each other out and have the net impact of mitigating risk and brining an exposure to zero. By adding together both the long and the short positions of multi-leg trades, the gross method simply creates a falsely inflated reportable leverage figure for the AIF. Ironically, AIFs that use interest rate, currency or other types of derivatives to minimise risk end up with very high leverage under the gross methodology.

While the commitment method allows more flexibility through netting, hedging and duration netting arrangements, it still does not allow for the full netting of two perfectly offsetting positions. Many issues and challenges arise with the application of these rules which lead to misrepresentations and inconsistencies. The issues arising with specific examples have been well documented by AIMA and provided to the Commission.

We would specifically like to draw the Commission's attention to the uncertainty and divergence that exists in relation to the treatment of cash and cash equivalents. Under Article 7 of AIFMD Level 2, the gross method expressly excludes cash and cash equivalents. On the other hand, Article 8 pertaining to the commitment method refers only to financial derivative instruments but we are seeing different parties interpret this differently.

One school of thought is that because there is no specific mention of cash in Article 8, this means that cash should be included in the calculation of leverage under the commitment method.

The second school of thought takes a reasoning based approach to the calculations, given all of the statements made under AIFMD Level 1 and Level 2 as well as under the CESR Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS. This school believes that the purpose of the commitment approach is to reduce the gross exposure. As such, they state that if for example the fund had no derivatives or borrowing, both the gross and commitment approaches should equal the same unlevered value. However, if you were to exclude cash from the gross approach and include it in the commitment approach then you would potentially have a situation where your commitment value was greater than your gross value.

This is not a situation which some AIFMs believe was intended and as such those AIFMs use the commitment approach as a follow-on from the gross approach (very similar to UCITS since it was initially based on the aforementioned CESR guide). The strongest argument for this approach is the definition of leverage within Article 4 (1)(v) of AIFMD Level 1:

"'leverage' means any method by which the AIFM increases the exposure of an AIF it manages whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means;"

This school of thought first separates the definition of leverage from the definition of exposure into different components and determines that the gross and commitment approaches are to compute exposure and must be further analysed to determine the actual leverage in accordance with the definition of leverage. In order to compute exposure under this approach you should include cash in the commitment approach within Article 8 only for the purpose of netting with cash based derivatives to further reduce exposure. That is the only reason this school of thought believes that cash is not specifically excluded within the wording of Article 8.

However, once the exclusions are performed through netting/hedging to reduce exposure, to compute the leverage you need to exclude any positions which do not increase the exposure of the fund beyond what a cash position would. As such, you would exempt cash and cash equivalents as they do not increase the exposure of the fund. This would be consistent with the definition of leverage.

More generally, if the intention of reporting under these leverage methodologies is to provide a way to measure and monitor systemic risk across the financial sector on a easily comparable basis, this is not being achieved. As documented by AIMA, the exposure rules used in banking provide different outcomes that cannot be compared with the restrictive gross and commitment methodologies applied to AIFs. The ESRB is therefore not in a position to compare like with like when measuring and monitoring system risk across the financial sector. This further emphasises the need for a consistent and meaningful methodology for measuring leverage across the financial sector.

Suggestions to remedy the issue(s) raised

Article 6(2) of AIFMD Level 2 provides that "*the Commission shall review, in the light of market developments and no later than 21 July 2015, the calculation methods referred to in the first subparagraph in order to decide whether these methods are sufficient and appropriate for all types of AIFs, or an additional and optional method for calculating leverage should be developed*."

We recommend that the Commission uses this review to introduce a third optional leverage calculation methodology to address the concerns that have been raised in relation to the gross and commitment methodologies.

The option to apply a Value-at-Risk ("**VaR**") methodology should be provided for, as it is under the UCITS framework. Leverage risks should be measured much the same way whether a fund is a UCITS or an AIF. The only difference between a UCITS and an AIF should be the leverage limits that are imposed on each. Although VaR does have its own shortcomings it is used by many practitioners to measure risk which at least makes it a consistently used tool across the industry and a more meaningful representation for investors. Thus, a standardised VaR approach in line with what is used for a UCITS would be the best third methodology in our view but obviously an AIF should not be subjected to the same 20% absolute or 2x benchmark relative VaR limits that are imposed on a UCITS.

AIMA has provided the Commission with a uniform methodology which could be availed of as a third optional leverage calculation methodology. Having a standardised third approach would enable investors to make a more meaningful comparison between the leverage risks of different strategies.

Additional guidance should also be given in the area of share class hedging techniques, and their impact on gross and leverage figures. For example, provided an AIFM is able to clearly demonstrate that an FX forward is being effectively utilised for share class hedging purposes (e.g. via the calculation of hedge ratios), then this should not contribute toward portfolio leverage figures.

The aim of calculating and publicising gross and commitment leverage figures should be to provide investors and regulators with the actual leverage employed by the AIF. To ensure consistency, a number of examples should be provided in the technical guidance.

Furthermore, to ensure consistency with UCITS, many of the concepts relating to the CESR's Measurement of Global Exposure document (CESR/10-788) should be considered, particularly for the measurement of OTC Counterparty Risk Exposure. Note that this suggestion is not asking that the investment restrictions of UCITS be applied to AIFs, but rather that the measurement concepts adopted be the same, hence allowing more meaningful aggregation of exposures across AIFs and UCITS.

Example 3

Additional investor disclosures imposed by Member States in the annual and half-yearly reports for UCITS

Legislation

UCITS

Summary of issue

Recital 58 of the UCITS Directive provides that "*Member States should make a clear distinction between marketing communications and obligatory investor disclosures provided for under this Directive. Obligatory investor disclosure includes key investor information, the prospectus and annual and half-yearly reports.*"

However, certain Member States, including France and Germany, require additional investor disclosures be included in the annual and half yearly reports above those contemplated by the UCITS Directive.

Supporting relevant and verifiable empirical evidence

For example, BaFin requires disclosure of where the fund documentation is available from the German [paying and] information agent, including their name and address. Furthermore, in circumstances where not all sub-funds of the UCITS are registered for offer in Germany, BaFin requires an additional statement to specify the names of the sub-funds whose units are not registered for marketing in Germany.

In the case of France, for UCITS which are considered eligible under the "Plan d'Epargne Actions" ("**PEA**") are required to include an appropriate PEA eligibility statement in their annual and half-yearly reports.

Suggestions to remedy the issue(s) raised

There is no provision for such additional disclosure requirements in the UCITS Directive and these requirements should therefore be removed.

Example 4

Portfolio statement under Article 69 of the UCITS Directive

Legislation

UCITS

Summary of issue

The UCITS Directive requires the annual and half-yearly report of a UCITS to include a portfolio statement listing each investment held, distinguishing between the various categories of transferable securities and analysed in accordance with the most appropriate criteria in light of the investment policy of the UCITS.

A detailed portfolio statement is not a requirement under IFRS or UK / Irish GAAP.

Supporting relevant and verifiable empirical evidence

This requirement leads to annual and half-yearly reports for a UCITS with highly diversified portfolios to be excessively long, diluting the relevance of such information for investors and making it more difficult to understand the UCITS exposures. Excessively long annual and half-yearly reports also result in additional unnecessary costs to the UCITS where such reports are printed and posted to all investors.

Suggestions to remedy the issue(s) raised

We would recommend that UCITS are given the option to either include a full portfolio statement listing of each investment held or a condensed portfolio statement listing investments (including financial derivative instruments) representing more than 5% of net assets, distinguishing between transferable securities and financial instruments other than transferable securities and analysed in accordance with the most appropriate criteria in light of the investment policy of the UCITS. Where a condensed portfolio statement is presented, it is suggested that the UCITS must then make the full portfolio statement available to investors on demand free of charge. The concept of a condensed portfolio statement is widely known in the investment management industry and is a requirement under US GAAP.

The UCITS Directive also requires the portfolio to be analysed both as a percentage of net assets and as a proportion of total assets. We would recommend that the requirement to analyse the portfolio as a proportion of total assets is removed as this is largely a duplicate and inconsistent to the requirement to analyse the portfolio as a percentage of net assets.

Example 5

Statement of changes in the composition of the portfolio under Article 69 of the UCITS Directive

Legislation

UCITS

Summary of issue

The UCITS Directive requires a statement of changes in the composition of the portfolio during the reference period. There is a different interpretation of this disclosure requirement resulting in an inconsistent disclosure in the UCITS annual and half yearly reports across Member States.

Supporting relevant and verifiable empirical evidence

For example, in Ireland the approach is to disclose material changes in the composition of the portfolio with material changes defined as aggregate purchases/sales of a security exceeding 1 per cent of the total value of purchases/sales for the relevant period.

In case of the UK, this requirement is satisfied by disclosing (i) comparative percentages to the portfolio holdings (ii) total value of purchases and sales (iii) narrative description of material changes in composition of the portfolio.

While in Luxembourg, changes in the composition of the portfolio are not required to be disclosed in the annual and half-yearly reports but need to be made available to investors upon request.

Suggestions to remedy the issue(s) raised

We would recommend that this disclosure requirement is clarified further as there is currently differing interpretations of this requirement across Member States.

Example 6

Comparative table under Article 69 of the UCITS Directive

Legislation

UCITS

Summary of issue

The UCITS Directive requires the annual report of a UCITS to include a comparative table including the total net asset value and net asset value per unit for the last three financial years.

Supporting relevant and verifiable empirical evidence

This disclosure requirement results in a detailed listing of the total net asset value and net asset value per unit for each unit class for the last three financial years. This is not consistent with the requirements of IFRS or GAAP in the UK and Ireland where comparative disclosures are only required for the previous financial year.

Suggestions to remedy the issue(s) raised

We would recommend that this requirement is aligned with the requirements of IFRS and general accepted accounting principles in the UK and Ireland whereby comparatives are provided for the previous financial year only.

Example 7

Income and expenditure account under Article 104 of AIFMR

Legislation

AIFMD

Summary of issue

The Regulation requires the classification of 'realised gains on investments' and 'unrealised gains on investments' within 'Income' and 'realised loss on investments' and 'unrealised loss on investments' within 'Expense'. This requirement conflicts with both the requirements of IFRS and general accepted accounting principles in the UK and Ireland. Furthermore, there is no guidance on how to calculate gains and losses for the purposes of Article 104, i.e. should the calculation be made on a transaction by transaction basis or an instrument by instrument basis. This has resulted in divergent practice amongst industry participants and it could be argued that the inclusion of the disaggregation of gains and losses is of limited use to readers of financial statements.

Supporting relevant and verifiable empirical evidence

IFRS and GAAP in the UK and Ireland require a single line item for net gains or net losses, including changes in fair value on investments which conflicts with the requirement in Article 104 to present realised/unrealised gains on investments as 'investment income' and realised/unrealised losses on investments as 'expenses'.

This conflict is resolved by the presentation of gains/losses on investments in accordance with the requirements of the relevant accounting standards and the inclusion of a supplementary disclosure in the annual report, disaggregating gains and losses in accordance with the requirement in Article 104.

Suggestions to remedy the issue(s) raised

We would therefore recommend that the requirement under Article 104 of AIFMR for classification of 'realised gains on investments' and 'unrealised gains on investments' within 'Income' and 'realised loss on investments' and 'unrealised loss on investments' within 'Expense' is replaced by a new separate caption as below. This would remove the need of supplemental disclosures in the annual report and also align the requirements for AIFs with UCITS funds.

(d) 'Appreciation or depreciation of investments', representing gains/losses on the disposal and revaluation of investments

Example 8

Tax reporting and compliance obligations in various EU Member States

Legislation

Not applicable at EU level

Summary of issue

Tax compliance and reporting obligations continue to increase for investment funds which have investors and/or investments in multiple EU Member States. This adds additional complexity and cost to investment funds and can act as a disincentive or barrier to entry for those who are not familiar or do not have the resources to comply with the reporting requirements.

National tax reporting for investors represents a particular difficulty as the nature and extent of the reporting required can vary significantly across Member States. As such, investment funds with investors in a number of different jurisdictions (such as Belgium, Germany, Austria and the UK) will be required to invest significant time and resources in managing its various tax compliance obligations.

Suggestions to remedy the issue(s) raised

The introduction of single pan-European tax reporting template for EU investment funds would greatly simplify the compliance obligations of investment funds, thereby reducing compliance costs and removing a potential barrier to CMU.

Issue 8 – Rules outdated due to technological change

Please specify where the effectiveness of rules could be enhanced to respond to increasingly online-based services and the development of financial technology solutions for the financial services sector.

Example 1

The appointment of a facilities agent

Legislation

UCITS

ELTIF

Summary of issue

The UCITS Directive provides that Member States may "*take the measures necessary to ensure that facilities are available in that Member State for making payments to unit-holders, repurchasing or redeeming units and making available the information which UCITS are required to provide.*" (Ref. Art. 92)

Similarly the ELTIF Regulation provides that “*The manager of an ELTIF the units or shares of which are intended to be marketed to retail investors shall, in each Member State where it intends to market such units or shares, put in place facilities available for making subscriptions, making payments to unit- or shareholders,* *repurchasing or redeeming units or shares and making available the information which the ELTIF and the manager of the ELTIF are required to provide.*" (Ref. Art. 26)

We agree that it is important for retail investors to have access to information and help in their local language, but do not agree that local physical facilities are necessary given the technology available today. In practice, these local facilities are rarely, if ever, used but have to be put in place at significant cost to the fund. It should be recognised that these facilities can equally be provided online or over the telephone rather than requiring a physical presence.

Supporting relevant and verifiable empirical evidence

A key part of the original UCITS Directive was the requirement for a local facilities and paying agent. These rules were set up at a time when cross-border bank transfers in the EEC were slow and expensive and it was difficult to obtain adequate information (in the appropriate language) on a cross-border basis (before the internet existed). Furthermore, the rules assume a model of direct sales of UCITS whereas in practice the vast majority of UCITS sales are intermediated through a local advisor or execution platform which is designed to facilitate payments and provide access to all the information a retail investor may need. The result is that currently managers put in place facilities agents and paying agency agreements around Europe which are in practice never used.

Suggestions to remedy the issue(s) raised

We recommend that the investor protection mechanisms set out in UCITS Article 92 and in ELTIF Article 23 should be clarified to reflect the widespread use of the internet, the ease with which cross-border payments can be made and the reality of contemporary distribution models.

We have recommended to ESMA in its Consultation Paper on draft regulatory technical standards under the ELTIF Regulation (2015/ESMA/1241) that these RTS should clarify that facilities referred to under Article 26 of the ELTIF Regulation "*may be provided through a local agent or by means of technical infrastructure, including online or telephone facilities*". We would welcome a similar clarification in respect of Article 92 under the UCITS Directive.

In short, European rules in this area should recognise the advances made since the first UCITS Directive in 1985, when such support may not have been available via technological infrastructure. The acknowledgment by the European Commission of considering the possibility of electronic or phone distance "facilities" would be fully in line with the Commission's general objective to achieve a Digital Agenda. In this context we welcome the following statement in the CMU Action Plan:

"*The Commission will undertake a comprehensive assessment of European markets for retail investment products, including distribution channels and investment advice, drawing on expert input. The assessment will identify ways to improve the policy framework and intermediation channels so that retail investors can access suitable products on cost-effective and fair terms. The assessment will examine how the policy framework should evolve to benefit from the new possibilities offered by online based services and fintech.*"

Furthermore, it is imperative that local regulators refrain from gold-plating the facilities agent requirements, for example by insisting on the appointment of a local entity in the Member State in which the ELTIF is distributed to retail investors in order to satisfy the facilities requirement. We note that certain Member States already disapply such requirements where marketing activities are restricted to qualified/professional investors only.

Issue 9 – Barriers to entry

Please document barriers to market entry arising from regulation that the EU should help address. Have the new rules given rise to any new barriers to entry for new market players to challenge incumbents or address hitherto unmet customer needs?

Example 1

The imposition of excessive fees by Member States for local registration

Legislation

UCITS

AIFMD

Summary of issue

National Competent Authorities are imposing in some cases very significant levies on investment funds seeking to register in their jurisdiction. This is not how the passports under UCITS and AIFMD were intended to work and there is little justification for the application of these fees, when notifications are undertaken by the home Member State with minimal effort required on the host Member State side. Such fees act as a significant barrier to entry, particularly for smaller managers. Also, for promoters with very large fund ranges, the local sub fund registration fees levied can become very significant and are highly disproportionate in several Member States. In other cases, Member Stats do not levy any fees, which underlines the lack of a level playing field regarding cross-border marketing and registration costs across Europe, despite efforts to harmonise marketing conditions across Europe and remove barriers to entry.

Supporting relevant and verifiable empirical evidence

Several Member States charge between €1,000 and €5,000 to register a sub fund locally. In many cases this is a recurrent annual charge, which may even be higher than the initial registration. It is not appropriate or justifiable that a host regulator charges a fee of €2,000 for example to simply maintain the sub fund on a local register which may be updated only infrequently in any case. Similarly, under the AIFMD EU passport and particularly under National Private Placement, some regulators are charging recurrent registration fees which run to several thousand euro while other Member States do not levy any fee.

Suggestions to remedy the issue(s) raised

Ideally, the current notification process could be further streamlined via a single notification coordinated by ESMA to enhance efficiencies and eliminate local charges. In any case further streamlining under the UCITS passport process should occur to align with that of AIFMD, whereby the home Member State assumes responsibility for ongoing reporting obligations (see previous Example 4 under Issue 5 regarding Article 93(7) of the UCITS Directive). This should entirely eradicate any justification for host Member State fees. In the absence of entirely eradicating host Member State fees, a maximum range for regulatory notification fees and tariffs could assist in reducing excessive costs.

Issue 10 – Links between individual rules and overall cumulative impact

Given the interconnections within the financial sector, it is important to understand whether the rules on banking, insurance, asset management and other areas are interacting as intended. Please identify and explain why interactions may give rise to unintended consequences that should be taken into account in the review process. Please provide an assessment of their cumulative impact. Please consider whether changes in the sectoral rules have affected the relevancy or effectiveness of the cross-sectoral rules (for example with regard to financial conglomerates). Please explain in what way and provide concrete examples.

Example 1

The potential application of the asset segregation rules under AIFMD and the UCITS Directive in light of ESMA's draft "Guidelines on asset segregation under the AIFMD" (ESMA/2014/1326)

Legislation

AIFMD

UCITS

MiFID

EMIR

Summary of issue

We agree with ESMA's stated objective in its Consultation Paper on asset segregation under AIFMD (the "**Consultation Paper**") to ensure that the interests of AIF investors are protected in the event of an insolvency. However, we do not consider that adopting a blanket approach requiring greater physical asset segregation would necessarily achieve greater investor protection or a more speedy return of the assets to the investor in the case of an insolvency. Our view is that all options can be equally regarded as valid and consistent with AIFMD and the relevant legal analysis has been provided to the Commission to support this position. It should be pointed out that the depositary has a responsibility to continually assess the local segregation arrangements to ensure that the risk of loss is minimised by putting the most appropriate segregation arrangements in place. The use of omnibus accounts is recognised under AIFMD and they are typically used in developed markets where the law had evolved to support their existence and legal counsel has mandated Option 4 (co-mingling of client assets but separation of proprietary assets) under ESMA's Consultation Paper as the most appropriate level of asset segregation. In other beneficial owner markets, typically emerging markets, Option 5 (AIF-by-AIF segregation) may be the most appropriate level of segregation for the depositary to put in place.

By mandating segregation between AIF and non-AIF assets, and between assets of different depositaries throughout the custody chain, as proposed under Options 1 and 2, the draft ESMA guidelines could be detrimental to investors by increasing operational risk and costs. The effect of this level of segregation would be to make the current tripartite collateral management and securities lending model unworkable, which has been designed to mitigate risk and cost. The unravelling of the tripartite model will have a significant spill-over impact on financing arrangements and liquidity in the market place.

Greater levels of physical account segregation also works against the recently introduced Target2Securities settlement infrastructure which is designed to introduce greater efficiencies through pooled accounts.

Mandating greater physical segregation would not be consistent with other relevant European regulatory frameworks. Both Article 38(5) of CSDR and Article 39 of EMIR offer clients the choice of enhanced segregation, but do not mandate it upon clients. With respect to Article 39 of EMIR, the general experience has been that clients have opted for omnibus accounts. MiFID II did not require further mandated segregation, which suggests that the legislators of MiFID II clearly accepted that omnibus segregation provides sufficient protection for clients of all levels of sophistication on the insolvency of a custodian. Finally, the Bank Recovery and Resolution Directive ("**BRRD**") establishes a recovery and resolution framework for EU credit institutions and investment firms. Article 31 of the BRRD sets out the resolution objectives, which include protection of client funds and client assets. We consider this to be the appropriate regulation in which any concerns around speed of return of assets is addressed.

Options 1 and 2 are also inconsistent with the UK's Client Assets Sourcebook ("**CASS**") rules and Ireland's Client Asset requirements ("**CAR**") which allow for the use of omnibus accounts and focus on the quality of the books and records, with regular reconciliations and reporting requirements, in order to improve the speed of return of assets on an insolvency.

Furthermore, AIFs risk being shut out of key markets such as the US due to the mistmatch that will arise between local jurisdiction securities ownership rules and the mandated level of segregation required under the Consultation Paper. This highlights the need for a carefully considered approach to asset segregation that takes into account the different nature and structure of markets globally and the various local protections afforded. Applying Options 1 and 2 across the board will not achieve that.

Supporting relevant and verifiable empirical evidence

<u>Protection of assets in an insolvency</u>

The commingling of AIF and non-AIF assets, and assets of different depositaries, at the level of a delegate or sub-delegate would not preclude the maintenance of high standards of investor protection where the depositary and its delegates maintain robust processes, procedures and associated controls in line with AIFMD to:

- Distinguish all records of an AIF's financial instruments
- Monitor the settlement cycle of the transactions relative to the financial instruments invested
- Oversee the assets' reconciliation process at the fund administrator level
- Reconcile on a periodic and ongoing basis the assets in an omnibus or collectively managed account with the depositary's books and records
- Minimise the risk of loss of financial instruments and assess the custody risks throughout the custody chain
- Exercise due care in relation to the financial instruments to ensure a high standard of investor protection

Depositories and their delegates undertake rigorous procedures to assure asset safety, including by assessing the suitability of their sub-delegates and making arrangements for holding intermediated securities that properly respond to local legal requirements in the jurisdictions where they are held. Overwhelmingly, these assets are ultimately held as client assets accounts of the local sub-custodian/sub-delegate in the local CSD. Whilst CSDs recognise client assets of CSD participants, it is not usually possible to sub-segregate amongst clients of the participant at the level of the CSD. This means that sub-segregation at the level of a delegate or sub delegate does nothing more than create another account at that sub-delegate.

Speed of return

We understand that the Association of Global Custodians ("**AGC**") has obtained legal advice relating to around 100 jurisdictions confirming that, in the vast majority of those jurisdictions, asset segregation, as set forth in the Consultation Paper would not be the dispositive or controlling factor in determining the recoverability of assets in the event of the sub-delegate's insolvency. Supplemental legal opinions have been obtained by depositaries and/or their relevant delegates that identify the additional or alternative factors that determine the recoverability of investor assets under relevant local laws in those and other jurisdictions in order to provide appropriate disclosure to investors and facilitate asset protection.

Given that the insolvency administrator of any given intermediary will look first to the books of the insolvent intermediary and then reconcile to positions held at such intermediary's delegate, there is no clear administrative advantage to sub-segregation at the level of the delegate. SSAE 16 and ISAE 3402 audit structures are in place to assure appropriate reconciliation of clients' assets accounts through chains of intermediation. Depositaries and/or their delegates have undertaken to engage local lawyers to provide information about local insolvency laws and the recognition of segregation arrangements. Segregation of omnibus accounts by client category has not been identified as a factor that would provide greater security in the case of the insolvency or other default of a sub-delegate/sub-custodian.

Operational impact and risks

Greater physical segregation would result in a vast proliferation of the number of omnibus account to hold assets. This would significantly increase settlement and counterparty risk due to increased errors on the investor in transferring funds into incorrect accounts, resulting in more failed trades. The proliferation of accounts will also increase operational complexity due to the increased amount of reconciliations, increased oversight of the number of accounts and error rectification that will be required. While depositaries may absorb one-off costs associated with new asset segregation requirements, increased transaction costs would have to be passed on to end investors who would no longer be able to achieve the economies of scale afforded by using omnibus accounts. This will result in more of the type of pricing seen in emerging markets being transferred to more developed markets. The increased costs may also encourage the use of synthetic trading via derivatives to gain exposure to markets rather than investing directly in the equities, which arguably may further increase risk.

Collateral management

Collateral management plays a vital role in the post-financial crisis economy by reducing risk in the financial system and increasing liquidity. It also enables additional income for funds, which is of benefit to their investors. Collateral management is an environment where beneficial ownership of collateral changes frequently (including intra-day). ESMA's Options 1 and 2 require extensive segregation along the chain of custody which does not work effectively where there are frequent changes of beneficial ownership at the investor level.

This would force the triparty collateral market to operate on a bilateral basis which would increase various risks (e.g. settlement risk, counterparty risk, operational risk) and reduce liquidity. The current tripartite collateral model is optimised for efficiency and for reducing settlement risk with the collateral agent assuming responsibility for dispute resolution and reconciliations. Without the benefit of this agent role, UCITS and AIFs would be forced out of the securities lending business, reducing the opportunity for funds to generate additional income in relation to their securities, for no substantive benefit. This would have major consequences for the operation of MMFs, ETFs and other funds engage extensively in securities lending to generate revenue.

Moreover, considering that around $300 bn is collateralised in UCITS each day, the withdrawal of funds from the market would have a severe impact on liquidity and funding which would be directly contrary to goals of CMU.

<u>US market</u>

The US regulatory regime governing the custody of securities by SEC regulated broker dealers, including all US prime brokers, is structured around the rules governing share ownership stated in the Uniform Commercial Code (the "**UCC**") and implemented in each State's law. Article 8 of the UCC covers the ownership and transfer of investment securities.

Most securities in the US are settled through the local CSD, the Depositary Trust Company, a subsidiary of the Depositary Trust & Clearing Corporation (the "**DTC**"), where only banks and broker dealers will have accounts. Most securities are not certificated and exist as an entitlement to the securities held in a broker dealer's account with the DTC in their 'Street Name'. The broker's name is listed in the DTC's ownership records, and the records of the security issuer's transfer agent identifies the DTC's nominee name (Cede & Co.) as the registered owner of all securities held by the DTC.

Each broker dealer must maintain books and records to identify the beneficial owners who are the entitlement holders of the securities held by the broker dealer in its participant account at the DTC (commonly referred to as the "Box"). Therefore the DTC holds legal title to the securities and the broker's client is the beneficial owner of those securities.

Article 8 of the UCC defines a security entitlement as "the rights and property interest of an entitlement holder with respect to a financial asset". The "entitlement holder" (the client in this instance) is defined as the "person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary". A "securities intermediary" is a clearing corporation, bank or broker that maintains a securities account for others which would be the prime broker in this instance.

The UCC requires a US broker to maintain financial assets "in a quantity corresponding to the aggregate of all security entitlements it has established in favour of its entitlement holders with respect to that financial asset". As such, the broker must always maintain an adequate number of securities to meet its client holdings.

This concept of ownership based on the investor's net equity claim is at odds with mandating granular physical account segregation, which would have no bearing under US insolvency law. The US market would not be in a position to comply with ESMA's draft guidelines on AIFMD asset segregation and consequently AIFs would be shut out of the US market.

Suggestions to remedy the issue(s) raised

We consider that all five Options outlined in ESMA's Consultation Paper should be available to market participants. All five options achieve investor protection, although in our view Options 1 and 2 increase operational risks and costs. We would encourage the Commission to take a more flexible approach to asset segregation in recognition of the different nature of markets and the different protections afforded in each of those markets, the depositary's liability standard and its duty to act in the best interests of the investors in assessing the most appropriate level of segregation to minimise the risk of loss.

Issue 11 – Definitions

Different pieces of financial services legislation contain similar definitions, but the definitions sometimes vary (for example, the definition of SMEs). Please indicate specific areas of financial services legislation where further clarification and/or consistency of definitions would be beneficial.

Example 1

Definition of "marketing" under AIFMD

Legislation

AIFMD

Summary of issue

The issue relates to the uncertainty as to what constitutes marketing under AIFMD. Marketing is defined under Article 4(1)(x) of AIFMD.

The conditions that must be met before AIFMs may market shares in AIFs in the EU are set out in AIFMD as set below, with each Article being applicable depending on the location of the AIFM, the AIF, where the marketing will be conducted and whether the passport will be availed of:

- Chapter VI "Rights Of EU AIFMs To Market And Manage EU AIFs In the Union" (Articles 31 to 33); and

- Chapter VII "Specific Rules In Relation To Third Countries" (Articles 34 to 42) (the "**AIFMD Marketing Articles**").

As outlined above, the AIFMD Marketing Articles set out the conditions that must be fulfilled before marketing can take place in the EU, depending on the category of AIFM, the category of AIF, the Member State(s) in which the marketing is to take place and whether the passport will be utilised.

Although "marketing" is defined in Article 4(1)(x) of AIFMD as "a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union", this definition is vague and is open to interpretation, particularly in respect to what would represent an "offering" or a "placement".

In order to address this ambiguity, some jurisdictions have issued guidance as to what constitutes marketing and what does not, with the latter sometimes being referred to as "pre-marketing".

This is in contrast to other jurisdictions, which have not issued any guidance and which, in many instances, take a very conservative approach and will prohibit an AIFM from making any contact with potential investors until the conditions set out in the relevant AIFMD Marketing Article have been met. This means that access to investors and fund raising in these jurisdictions is much less efficient.

Supporting relevant and verifiable empirical evidence

For example, the Financial Conduct Authority in the United Kingdom (the "**FCA**") has issued guidance on marketing which is set out in 'Chapter 8: Financial promotion and related activities' of its Perimeter Guidance Manual ("**PERG 8**"). In PERG 8, the FCA has interpreted an offering or placement to mean "*when a person seeks to raise capital by making a unit or share of an AIF available for purchase by a potential investor*". The FCA goes on to say that this covers (i) making a contractual offer that can be accepted by a potential investor in order to make a purchase of such unit or share and form a binding contract and (ii) making an invitation to the investor to make an offer to subscribe for such unit or share. Furthermore, such marketing can only be carried out when the fund documentation and information set out in Annex III of AIFMD are in materially final form.

In light of the above, if the relevant fund documentation is not in materially final form and/or an investor is not able to subscriber for units or shares in an AIF (e.g., because the initial offer period has not yet commenced), pursuant to PERG 8 no marketing can take place and any activities carried out by the AIFM would constitute "pre-marketing". As a result, such activities would be outside the scope of the AIFMD Marketing Articles.

The clarity provided by the FCA is very helpful to AIFMs and makes it clear that they are able to carry out "pre-marketing" at any early stage of a product's development and that the AIFM only needs to meet the conditions set out in the relevant AIFMD Marketing Articles at the time that the AIF actually launches (i.e., when the initial offer period opens and units/shares are available for subscription), at which point any interaction with an investor becomes marketing.

This clarity is of benefit to investors because it means that they can consider a potential product from an AIFM while it is still being developed and, if necessary, can give feedback which might lead to changes being made to the AIF to make it more attractive to investors before it is actually launched. This is also of benefit to AIFMs as it makes the launch of an AIF more efficient and cost effective (leading to lower establishment costs being borne by the AIF).

Suggestions to remedy the issue(s) raised

ESMA should issue guidance on the definition of marketing so that the current differences between Member States would be eliminated.

Furthermore, it would be in the best interests of investors and AIFMs if the difference between marketing and pre-marketing was clarified so that AIFMs were clear that:

(i) they could conduct pre-marketing and approach investors before the units/shares in an AIF were available for subscription without meeting the relevant conditions set out in AIFMD Marketing Articles; and

(ii) once the units/shares in the AIF were available for subscription, any approach to investors would constitute marketing and could not take place unless the AIFM has met the relevant conditions set out in AIFMD Marketing Articles.

Example 2

Lack of a common and consistent definition of custody and safekeeping in EU legislation which has led to different interpretations of when Central Securities Depositaries are acting as delegates of depositaries and when they are not

Legislation

AIFMD

UCITS V

CSDR

Summary of issue

Recital 21 and Article 22a 4 of UCITS V Level 1 Directive provides different interpretations of circumstances under which CSDs are to be treated as 'delegates' of a UCITS depositary under UCITS V. We also suggest that different interpretations exist as to relationship between CSDs and depositaries as a result of the recent ESMA Q&A on the Application of AIFMD relating to CSDs which appears to be inconsistent with Article 21.11 of AIFMD.

In general there is an inconsistent overlap in the requirements between AIFMD, UCITS V and CSDR which could be addressed with a common and consistent definition of custody.

Supporting relevant and verifiable empirical evidence

We understand the policy intention of Recital 21 and Article 22a.4 of UCITS V is to describe those CSDs that are not to be treated as delegates of a UCITS depositary when providing safekeeping of financial instruments of a UCITS. However the range of services falling outside the scope of delegation under Recital 21 would appear to be different and in fact much narrower than under Article 22 a 4.

Recital 21 provides as follows:

"*When a Central Securities Depositary (CSD), as defined in point (1) of Article 2(1) of Regulation (EU) No 909/2014 of the European Parliament and of the Council (1), or a third-country CSD provides the services of operating a securities settlement system as well as at least either the initial recording of securities in a book-entry system through initial crediting or providing and maintaining securities accounts at the top tier level, as specified in Section A of the Annex to that Regulation, the provision of those services by that Regulation, the provision of those services by that CSD with respect to the securities of the UCITS that are initially recorded in book-entry system through initial crediting by that CSD should not be considered to be a delegation of custody functions*."

Article 22a.4, by contrast, excludes all CSDs that provide services in a Securities Settlement System capacity. Article 22a.4 would therefore provide for a wider range of CSDs as falling outside the scope of delegation requirements. Furthermore the last sentence of Recital 21 provides that "*entrusting the custody of securities of the UCITS to any CSD, or to any third-country CSD should be considered to be a delegation of custody functions*." This appears to be a contradiction to the prior sentence (quoted above) and thereby creates uncertainty as to when and under what circumstances a CSD would and would not be considered a 'delegate'.

Further evidence of this lack of clarity and uncertainty can be found in ESMA's recent response in a Q&A on Application of the AIFMD:

Question 8 [last update 1 October 2015]: *When assets of an AIF held in custody by the depositary of the AIF are provided by that depositary to a CSD or a third country CSD as defined under Regulation (EU) No 909/2014 (CSDR) in order to be held in custody in accordance with Article 21(8) of the AIFMD, does the CSD or third country CSD have to comply with the provisions on delegation set out under Article 21(11) of the AIFMD?*

Answer 8: *Yes.*

Again this appears to be inconsistent with Article 21(11) of AIFMD:

"*…the provision of services as specified by Directive 98/26/EC by securities settlement systems as designated for the purposes of that Directive or the provision of similar services by third-country securities settlement systems shall not be considered a delegation of its custody functions.*"

This lack of clarity and consistency means that the requirements are open to different interpretations by CSDs and depositaries which will cause significant challenges to the proper implementation of UCITS V requirements by 18 March 2018. Of particular concern are the segregation, eligibility and due diligence requirements which must apply to delegates under Article 22a of UCITS V and may be unworkable for some financial market interoperability arrangements such as Target2Securities and Shanghai-Hong Kong Stock Connect.

Suggestions to remedy the issue(s) raised

A common definition of 'custody' is required across all relevant legislation such as AIFMD, UCITS V and CSDR. This definition needs to recognise the different elements of a custody service as well as the different providers including custodians, prime brokers, collateral managers, CSDs acting in an issuer CSD capacity, CSDs acting in an investor CSD capacity and financial market infrastructure interoperability arrangements. This should all be considered with overriding focus on transparency, consistency and investor protection. The performance of services by CSDs in connection with their role as the mandated local market infrastructure operating as Securities Settlement Systems should not be viewed as a delegation of custody, for example in the case of Target2Securties or Shanghai-Hong Kong Stock Connect.

Issue 12 – Overlaps, duplications and inconsistencies

Please indicate specific areas of financial services legislation where there are overlapping, duplicative or inconsistent requirements.

Example 1

Overlaps, duplications and inconsistencies in financial services remuneration legislation and resultant excessive complexity and compliance burden

Legislation

AIFMD

UCITS V

CRD IV Directive

Summary of issue

In so far as the financial sector is concerned, remuneration rules are set out in CRD IV, AIFMD, the UCITS Directive and associated delegated acts and guidelines. The remuneration rules set out in each of these directives are largely based on the same principles. The most significant difference is that CRD IV contains a bonus cap, whereas UCITS and AIFMD do not. There are also differences in the disclosure requirements.

Supporting relevant and verifiable empirical evidence

We are deeply concerned that an uneven playing field has emerged between those asset managers that are consolidated within a group which is subject to the CRD IV remuneration requirements, and those which fall outside the remit of CRD IV: in particular, the first are subject to the bonus cap, while the second are not. The application of the CRD IV remuneration requirements to asset managers that are group entities means that asset managers are subject to two different requirements, depending on whether they are consolidated subsidiaries or wholly independent entities. Moreover, the fact that the so-called bonus cap under CRD IV cannot be disapplied on a proportionality basis is fundamentally contrary to the underlying rationale of the remuneration rules applicable in the funds sector. While the purpose of the bonus cap in CRD IV is partially connected to financial stability concerns, these concerns are not relevant in the funds context. Moreover, in the CRD IV context, a significant number of commentators have observed that the impact of the bonus cap has been to increase fixed salary as a component of overall salary, thus leading to a disconnect between remuneration and performance. In the funds context, the application of the bonus cap will mean that investors end up paying more for flat or negative performance and will be unable to reward positive performance effectively. This can result in a fundamental misalignment between the interests of investors with those of the portfolio manager/asset management company.

We also have concerns regarding the application of the remuneration requirements in the context of delegates. By virtue of level 3 legislation, the AIFMD remuneration requirements, and the draft UCITS requirements apply to delegates, and AIFMs/UCITS management companies must ensure that their delegates are either subject to equally effective regulatory requirements on remuneration or put in place appropriate contractual arrangements with those delegates. Given the international nature of investment funds, and in particular investment managers, increased recognition should be given to prudential requirements in non-EU jurisdictions which, like the EU rules, seek to align remuneration and risk, even if they take a different approach to achieving this alignment. In particular, a stringent application of the EU's remuneration requirements threatens to deprive EU investors of access to the best available investment management expertise in non-EU markets and to place EU asset managers at a competitive disadvantage internationally. It also means that some investment managers are subject to two distinct regulatory regimes leading, in some cases, to a significant compliance overlap. While we recognise that applying the look-through approach to all delegates helps prevent the circumvention of the remuneration requirements, we query its necessity. The EU rules already contain explicit anti-circumvention provisions and the regulation of non EU investment managers is more appropriately a matter for the relevant third country. The look-through to delegates raises additional problems in the context of group entities that are subject to the CRD IV remuneration requirements. Specifically, the application of the bonus cap to non-EEA delegates could exacerbate the difficulties posed by the UCITS/AIFMD remuneration requirements for EEA-based managers accessing non-EEA expertise.

Both AIFMD and the UCITS Directive require fund managers to include remuneration information in the annual reports they prepare for their relevant funds. While Article 450 of the CRD IV Regulation requires institutions to disclose certain information regarding their remuneration policy and practices, they have a broad latitude as to how this information is disclosed. In particular Article 434 states that institutions may determine the appropriate medium, location and means of verification to comply effectively with the disclosure requirements. Fund managers should be given similar latitude regarding the disclosure of remuneration information. In particular, they should not be required to disclose this information in an annual report and it should be sufficient if they indicate in that report where such information can be found, for example, a website address.

The principle of proportionality attempts to tailor the application of the remuneration requirements to specific entities. In the CRD IV context, the EBA has recently proposed a legislative change which would exclude certain small, non-complex institutions from the requirements to apply the remuneration principles regarding deferral and payment in instruments for variable remuneration, and to limit the scope of those remuneration principles as regards staff who receive low amounts of variable remuneration, including in large institutions.

To the extent that the Commission intends to propose amendments in this regard, it should also consider whether similar amendments should apply in the funds sector.

More generally, we would like to stress the need for better coordination between the European Commission and the various European Supervisory Authorities. The EBA's recent consultation paper on CRD IV remuneration requirements, in which it proposed a fundamental reassessment of the proportionality principle gave rise to considerable controversy and insecurity in the industry as well as some degree of cost, as entities tried to anticipate the consequences of the introduction of the draft guidelines set out in that paper. While we recognise that the purpose of consultations is to solicit views on a proposed approach, we believe that a proposal to fundamentally revise a key principle should have been handled with a higher degree of circumspection. At the very least, the proposed implementation deadline should have taken into consideration the revolutionary nature of the proposed changes.

Suggestions to remedy the issue(s) raised

1. Revise the rules applicable to asset managers who are part of a group entity so that they are not subject to the CRD IV remuneration requirements.

2. Abolish the look through approach for non-EU delegates.

3. Remove the requirement for fund managers to report remuneration information in the annual report.

4. To the extent that the Commission proposes to exclude certain small, non-complex institutions from some of the remuneration requirements, consideration should be given as to whether this exclusion should also apply to fund managers.

5. Better handling of proposed revisions of fundamental principles such as the proportionality principle. This should include better coordination between the competent EU authorities. Consideration should also be given to providing extended implementation periods where proposed changes will dramatically affect the status quo.

Example 2

Extra territorial challenges arising from reporting obligations for prime brokers under AIFMD

Legislation

AIFMD

Summary of issue

Article 91.3(c) and AIFMR requires the AIFM to ensure the an appointed prime broker make available to the depositary a statement containing certain prescribed information including "*the value of assets where the prime broker has exercised a right of use in respect of the AIF's assets*."

This requirement does not differentiate between European Prime Brokers and US Prime Brokers and it is not possible for US Prime Brokers to provide the prescribed reporting as they are not required to do so in their 'home' jurisdiction.

Supporting relevant and verifiable empirical evidence

The US regulatory regime governing the custody of securities by SEC regulated broker dealers, including all US prime brokers, is structured around the rules governing share ownership stated in the Uniform Commercial Code (the "**UCC**") and implemented in each State's law. Article 8 of the UCC covers the ownership and transfer of investment securities.

Article 8 of the UCC defines a security entitlement as "*the rights and property interest of an entitlement holder with respect to a financial asset*". The "entitlement holder" (the client in this instance) is defined as the "*person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary*". A "securities intermediary" is a clearing corporation, bank or broker that maintains a securities account for others which would be the prime broker in this instance.

The UCC requires a US prime broker to maintain financial assets "*in a quantity corresponding to the aggregate of all security entitlements it has established in favour of its entitlement holders with respect to that financial asset*". As such, the prime broker must always maintain an adequate number of securities to meet its client holdings.

Unusually, a security may be registered in the name of a client or payable to the order of, or specially endorsed to the client. If it has not been endorsed to the broker, the client would be treated as holding the security directly rather than as having a security entitlement with respect to that asset.

To the extent that a client has obtained financing from its US prime broker, and to the extent that the prime brokerage agreement permits it, the client's collateral will be eligible to be re-used by the prime broker up to the value equal to 140% of the client's net debit balance (including loan balances and any negative mark-to-market on short positions) to the broker (as limited under the FINRA/SEC rules) or such lesser value as agreed between the client and the prime broker.

To the extent that securities are fully funded or fall outside the permitted parameters of rehypothecation (known as excess margin securities), the SEC rules require the prime broker to segregate those securities on such prime broker's books and records and they are not available for rehypothecation. The DTC operates an inventory control mechanism called Memo Segregation to support prime brokers' segregation of segregated securities and excess margin securities. Although identifying securities as subject to Memo Segregation does not transfer them to a separate account at DTC, the effect is to facilitate identification of those securities which the prime broker must segregate in its books and records and also facilitates the determination of securities available for rehypothecation. Each prime broker may provide DTC with standing instructions from Memo Segregation options which have the effect of designating the relevant securities as subject to Memo Segregation.

Operationally, rehypothecation is typically processed in three stages although there may be individual nuances between different US prime brokers:

i) The prime broker calculates each client's debit balance to determine the value of the client's assets that are eligible for rehypothecation (up to 140% of the net debit balance).

ii) The prime broker systematically identifies for each client the fully paid and excess margin securities and the securities that are available for rehypothecation.

iii) From the securities available for rehypothecation, the prime broker determines which securities it wishes to use. This optimization process may lead to less than 140% actually being rehypothecated due to the requirement for particular securities at a specific point in time.

The maximum value of assets that can be rehypothecated is reported as the total value of each client's available securities that are available for rehypothecation. These securities are made available for rehypothecation and the daily rehypothecation report adequately details the value of assets over which the prime broker has a right of use.

For the purposes of compliance with AIFMR Article 91.3(c), US prime brokers have indicated that due to the securities holding framework in the US market it is not possible for them to identify or report which specific shares in an individual client's portfolio have been rehypothecated. However, the prime broker can report on the value of assets that are available for rehypothecation for each client.

Suggestions to remedy the issue(s) raised

Acknowledgement (perhaps by way of a Q&A rather than amending AIFMR) that it may not be possible for third country prime brokers to satisfy precisely the requirements of Article 91.3(c), however, satisfaction of regulatory rules in that third country which have the same effect will be sufficient.

Example 3

Overlap between investment fund legislation and the Prospectus Directive

Legislation

AIFMD

ELTIF

EuVECA / EuSEF

Prospectus Directive

Summary of issue

Certain entities (such as closed-ended funds and certain REITs) can be subject to both the Prospectus Directive and the AIFMD when making an offer of shares/units. There is considerable (and at times contradictory and unhelpful) overlap between the Prospectus Directive and AIFMD. Such entities fall under the Prospectus Directive insofar as their activities relate to the offering of securities throughout the EU. Offers of securities in such entities also come within scope of AIFMD if they fall within the definition of an AIF and have an authorised AIFM insofar as their activities relates to the marketing of units or shares of AIFs in the EU.

Supporting relevant and verifiable empirical evidence

In addition to the extensive disclosure requirements applying under the Prospectus Directive regime, AIFMD contains extensive investor disclosure requirements under Articles 22 and 23 and the accompanying AIFMR Articles 103 to 109. ELTIFs are also subject to further transparency, prospectus and disclosure requirements under Articles 23, 24 and 25, including the requirement for ELTIFs marketing to retail investors to provide a Key Information Document ("**KID**") as prescribed under the Packaged Retail and Insurance-based Investment Products Initiative Regulation ("**PRIIPS**"). EuVECA and EuSEF are also subject to their own disclosure requirements in areas such as the investment objectives, costs, conflicts of interest, remuneration and the annual report. To make AIFs subject to two overlapping sets of extensive disclosure requirements is disproportionate and potentially confusing to investors.

Suggestions to remedy the issue(s) raised

We would suggest that if an entity (be it a REIT or a closed-ended fund) has complied with the terms of the Prospectus Directive in respect of the offering of securities, then it should not also be subject to separate marketing or public offer rules under the AIFMD or under local national legislation relating to offers to retail investors, as that would run contrary to the harmonisation of public offer rules that the Prospectus Directive sets out to achieve and is inconsistent with the objectives of CMU.

ELTIFs should be exempted from the obligation to issue a prospectus under the Prospectus Directive as this would constitute an additional layer of disclosures without adding value to the existing and extensive disclosure requirements under the AIFMD as well as under the KID to be provided as part of PRIIPS. It should be further assessed what is the right level of disclosures in the case of listed ELTIFs.

We also propose that EuVECA and EuSEF funds should be exempted from the Prospectus Directive requirements as these funds are marketed only to professional and “semi-professional” investors. The Prospectus Directive regime is disproportionate for these funds would add an additional layer of disclosures without adding value for investors.

Example 4

Prohibition on AIFMs from also being authorised as MiFID investment firms

Legislation

AIFMD

MiFID

Summary of issue

It is clear from AIFMD that it is not possible for entities to be authorised as both a MiFID investment firm and an AIFM. Specifically Article 6(2) provides that an external AIFM may not carry out MiFID investment services and activities unless those services are limited to the MiFID investment services and activities of: (individual) portfolio management; investment advice; safe-keeping and administration in relation to shares or units of collective investment undertakings; and reception and transmission of orders in relation to financial instruments.

An external AIFMD may, however, delegate portfolio management to a MiFID investment firm, subject to compliance with the relevant rules on delegation set out in AIFMD and related measures. This means that in some cases the portfolio management of funds is effectively subject to two regulatory regimes: AIFMD at the level of the AIFM and MiFID at the level of portfolio management.

Supporting relevant and verifiable empirical evidence

This seems to us to undermine any potential rationale for preventing a MiFID investment firm from becoming an authorised AIFM. Prior to AIFMD, MiFID firms were frequently appointed as managers for hedge funds. Many of the investor protection requirements set out in AIFMD and MiFID overlap. There seems to be no clear reason why MiFID firms should not have a dual authorisation as an AIFM, subject to the requirement to apply the more relevant provisions in cases of conflicting provisions.

Suggestions to remedy the issue(s) raised

Remove the prohibition on AIFMs from also being authorised as MiFID investment firms.