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from: Secretary-General of the European Commission,  
signed by Mr Jordi AYET PUIGARNAU, Director

date of receipt: 19 December 2012

to: Mr Uwe CORSEPIUS, Secretary-General of the Council of the European  
Union

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Subject: COMMISSION DELEGATED REGULATION (EU) No ../.. of 19.12.2012  
supplementing Directive 2011/611/EU of the European Parliament and of the  
Council with regards to exemptions, general operating conditions, depositaries,  
leverage, transparency and supervision

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Delegations will find attached Commission document C(2012) 8370 final.

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Encl.: C(2012) 8370 final



Brussels, 19.12.2012  
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**COMMISSION DELEGATED REGULATION (EU) No .../..**

**of 19.12.2012**

**supplementing Directive 2011/61/EU of the European Parliament and of the Council  
with regard to exemptions, general operating conditions, depositaries, leverage,  
transparency and supervision**

(Text with EEA relevance)

## EXPLANATORY MEMORANDUM

### 1. CONTEXT OF THE DELEGATED ACT

The Directive on Alternative Investment Fund Managers<sup>1</sup> (AIFMD) introduces harmonised requirements for entities involved in the management of alternative investment funds (AIFs) marketed to professional investors in the EU.<sup>2</sup> Minimum standards are being set for the managers of AIFs that are marketed to retail investors under national rules.

The Directive covers a wide variety of AIFs and their managers (AIFM) ranging from equity funds to funds investing in illiquid assets (real estate, private equity, infrastructure, commodities or goods such as wine or art). It covers all possible investment strategies and legal forms of AIFMs and AIFs.

To obtain authorisation the AIFM has to comply with the requirements of the Directive, which range from, among other things, capital requirements, risk and liquidity management, and the appointment of a single depositary to rules regarding disclosure to investors and reporting to competent authorities.

With the AIFMD, all investment funds in the EU fall into one of the following two categories: they are either UCITS (undertakings for collective investment in transferable securities) or AIFs. UCITS funds are governed by the UCITS Directive (2009/65/EC) and are authorised for sale to the retail market. They are not the subject of this Delegated Regulation.

With almost € 6trillion of assets under management in the EU the UCITS sector is almost three times as big as the AIF sector (€ 2.2trillion). In 2010, the overall assets under management (AuM) by all categories of AIFs amounted to 18% of EU GDP. More than two thirds (68%) of the assets of AIFs are held by institutional investors, 70% of which are pension funds or insurance companies.

The AIFMD makes provision for a very extensive set of implementing measures ('level 2 measures') covering a wide range of topics which include, among other things: calculation of the assets under management, the method for calculating the leverage, clarification of certain operating conditions for AIFMs, the delegation of AIFM functions, specific provisions related to risk and liquidity management, clarification of a depositary's duties and liability, transparency requirements, and rules relating to third countries.

This Delegated Regulation implements the empowerments for delegated acts contained in the AIFMD and thereby creates a single rulebook that ensures a level playing field among AIFMs in the Union.

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<sup>1</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF>

<sup>2</sup> The AIFMD also covers the marketing of AIFs established in third countries to professional investors in the Union and the management of AIFs established in the Union, even if they are not marketed to investors in the Union.

A Regulation is the appropriate legal instrument for creating a single rulebook that contains uniform rules for all AIFMs. Since there is no substantial transposition, the risk of divergent application in the different Member States is avoided. As a consequence, the use of a Regulation facilitates the cross-border management and marketing of AIFs by AIFMs.

## **2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT**

While the AIFMD does not contain deadlines for the delivery of these delegated acts, the Commission aims to adopt the entire package of implementing legislation before the end of the transposition period for the AIFMD (July 2013).

On 2 December 2010, the Commission sent a request for technical advice on the level 2 measures to the Committee of European Securities Regulators (CESR). The European Securities and Markets Authority (ESMA, which replaced the CESR as of 1 January 2011) transmitted its technical advice to the European Commission on 15 November 2011.

Throughout the process of drafting its advice, ESMA was in close contact with the industry through bilateral meetings and public consultations. Stakeholders showed great engagement, as evidenced by the number of responses that ESMA received to its written consultations.

In addition to the written consultations, ESMA organised three open hearings covering the Call for Evidence and the two parts of the draft technical advice, the first in January and the other in September 2011. ESMA also invited around 20 selected experts to participate in a series of targeted workshops on the different parts of the technical advice between March and May 2011.

The Commission itself held extensive discussions with national supervisors and stakeholders, in particular trade associations, fund managers, and depositaries, from Member States and from non-EU countries, including major financial centres such as the Channel Islands, the Caribbean islands, the United States and Switzerland.

In line with its "Better Regulation" policy, the Commission conducted an impact assessment (IA) of policy options related to eight strategic issues in six domains that were to be covered by the Delegated Regulation: (1) the calculation of assets under management, (2) the method for calculating leverage, (3) additional own funds, (4) the depositary's duties and liability, (5) reporting frequencies, and (6) the use of leverage on a substantial basis.

The draft IA report was examined by the Impact Assessment Board (IAB) by written procedure in February/March 2012. On the basis of the IAB's opinion of 16 March 2012 the draft IA report was revised in order to take the views of the IAB into account as far as possible.

In order to clarify the scope of the initiative, some more background on the initiative has been provided. In the chapter on 'options' the limitations set by the AIFMD have been explained in more detail. The analysis of impacts includes some discussion of the extent to which impacts are triggered by level 1 and by level 2. The suggestion to strengthen the analysis of impacts with quantitative input could not be followed as such information could not be obtained from the industry or supervisory bodies or any other third party.

A comparison of the options against a 'do nothing' was not possible as there is no clear-cut baseline. It is not trivial to define an appropriate baseline for these level 2 measures as they,

on the one hand, address an area which has not been regulated at Union level so far, in parts not even at national level, but on the other hand will be affected by the impacts of the level 1 Directive anyway. It is also almost impossible to construct such a baseline in a meaningful way that would allow quantifying impacts because of the differences in current practices on the one hand and in the ways the AIFMD would be transposed if no level 2 measures were adopted. To improve the presentation, the report has been shortened in some parts. The impact analysis sections have been amended with indications as to how the preferred options in this impact assessment deviate from the technical advice by ESMA.

### **3. LEGAL ELEMENTS OF THE DELEGATED ACT**

#### **3.1. Subsidiarity and proportionality**

The European Commission's and the EU's right to act is discussed in the impact assessment which accompanied the AIFMD. The AIFMD aims to provide a clear and consistent framework for the regulation and supervision of AIFMs in the EU; it establishes at European level a mechanism for creating a single European market for alternative investment funds in line with the legal basis underpinning EU legislation in this area (Article 53(1) TFEU).

The legal basis for delegated acts is provided (and circumscribed) by the power to adopt delegated acts and implementing measures conferred on the Commission in Articles 56 to 58 of Directive 2011/61/EU. The Directive requires delegated acts and implementing measures to be adopted in specified areas in order to ensure that the Directive is implemented consistently across the EU.

##### *3.1.1. Choice of the legal form*

A single rule book is essential for AIFMs as, given the cross-border activities of such managers, they have to comply with a uniform set of rules, such as: diligence requirements, inducements or conflicts of interest, which may arise in the course of their activities. It has been acknowledged that although the impact of AIFMs on the market is largely beneficial, their activities may also amplify risks through the financial system. It is therefore necessary that requirements related to the risk and liquidity management, valuation and investments in securitisation positions are even and applied in the same manner by AIFMs irrespective of the Member State where they are authorised. Furthermore, the Delegated Regulation contains detailed requirements concerning the calculation of assets under management, methods and calculation of leverage as well as the content and frequency of reporting to competent authorities and investors. Similarly, precise and unequivocal rules on delegation and depositaries are warranted. They mark a clear line between the tasks and responsibilities of the AIFM, the AIF's depositary and the AIFM's delegate, if appointed. It should be noted, however, that the family of AIFMs and AIFs is so diverse that it is neither possible nor desirable to try to create tailored rules for each type of AIFM. Therefore, this Delegated Regulation has to allow for certain flexibility so that its rules can be applied in a proportionate way, where justified by the size and the organisation of the AIFM and the nature, scale and complexity of the managed AIF. It is the role of competent authorities to supervise the manner in which AIFMs apply the Delegated Regulation.

A single rule book covering all aspects of managing AIFs is necessary in preparing for the smooth introduction of a marketing and operating passport for third country managers. Only a high level of convergence between management and quality standards would ensure a level playing field between EU based operators and those established in other jurisdictions.

The form of a Regulation is the best possible guarantee to ensure a level playing field, uniform conditions of competition and the highest possible standard of investor protection.

### *3.1.2. Subsidiarity and proportionality*

This Delegated Regulation should ensure the requisite degree of harmonisation, taking due account of the principle of subsidiarity. Given the nature and scope of this Regulation, action solely at Member State level would not be able to effectively or efficiently address those issues, given the centrality of the single market and the cross-border dimension of the AIFM sector. Action solely at Member State level would run the risk of creating or maintaining barriers to further integration and of impeding the efficient management and marketing of AIFs in the EU, thereby potentially raising costs and risks for investors, while also increasing administrative costs.

The principle of proportionality requires that any intervention is targeted and does not go beyond what is necessary in order to achieve the objectives. This principle has guided the process from the identification and evaluation of alternative policy options to the drafting of this proposal.

## **3.2. Detailed explanations of the proposal**

### *3.2.1. Calculation of assets under management (Articles 2-5) - Article 3 AIFMD*

The Delegated Regulation establishes the procedure to be followed by an AIFM when calculating its assets under management (AuM) and the methodology to be used for specific categories of assets (Article 2). In accordance with Article 2, the AIFM has to calculate total AuM by determining the value of all assets it manages, without deducting liabilities, and valuing financial derivative instruments (FDIs) at the value of an equivalent position in the underlying assets. Valuing FDIs as if the underlying assets were acquired by the fund represents a key policy choice as this method of valuation best reflects the AIF's exposure to those assets.

The Regulation also requires assets under management to be constantly monitored by the AIFM (Article 3) and action to be taken when the thresholds laid down in Article 3 AIFMD are occasionally breached (Article 4). Competent authorities should have the right to check the correctness of the calculation (Article 5).

### *3.2.2. Methods and calculation of leverage (Articles 6-11)- Article 4 AIFMD*

Article 4(1)(v) AIFMD defines leverage as 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. The AIFMD makes the use of leverage subject to several obligations. For example, the AIFM has to report figures on leverage to investors and supervisory authorities<sup>3</sup>, it has to set out the policy with regard to leverage when applying for authorisation<sup>4</sup> and it has to set a maximum level of leverage which it may employ on behalf of each AIF it manages<sup>5</sup>. In order to ensure uniform

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<sup>3</sup> Article 24(4) of Directive 2011/61/EU

<sup>4</sup> Article 7(3)(a) of Directive 2011/61/EU

<sup>5</sup> Article 15(4) of Directive 2011/61/EU

compliance with these obligations and achieve the aim of the AIFMD to grant an objective overview of the leverage used by an AIFM, Articles 6 to 11 of the Regulation provide two methods for calculating the leverage.

According to the IA, the best results are achieved by combining what are known as the ‘gross’ and ‘commitment’ methods. The leverage ratios that result from applying the gross method are consistent with the objective of monitoring macro-prudential risks. The commitment method is well established and recognised in the asset management sector. Its results can be easily compared with those for UCITS funds. It provides, in particular when combined with the gross method, a good insight into the investment strategies and exposure of AIFs relevant for both investors and supervisors. As reflected in recital 12, if it is necessary, the Commission may adopt additional delegated acts on an additional and optional method for the calculation of leverage, on the basis of technical advice developed by ESMA. Recourse to an advanced method should not obviate the calculation of leverage according to the gross and commitment method —both remain obligatory for all AIFMs.

### *3.2.3. Additional own funds and professional indemnity insurance (Articles 12-15) - Article 9 AIFMD*

The AIFMD requires AIFMs to hold appropriate additional own funds or professional indemnity insurance (PII) to cover potential liability risks arising from professional negligence. This Delegated Regulation specifies the appropriateness of such additional own funds or PII to ensure that AIFMs hold sufficient coverage to protect investors.

To determine the appropriateness of coverage the Delegated Regulation establishes a common definition for professional liability risks, provides an indicative list of events to be covered (Article 12), and lays down some qualitative requirements for AIFMs to appropriately monitor operational risks (Article 13). An AIFM’s additional own funds are considered to be appropriate if they represent at least 0,01% of the value of the portfolios of AIFs managed, the amount being subject to on-going adjustments to reflect the risk profile of the AIFM (Article 14). Several qualitative and quantitative conditions are established for determining the appropriateness of professional indemnity insurance when it is chosen by the AIFM for covering its professional liability risks (Article 15): PII with a coverage of 0.9% of AuM for claims in aggregate per year and 0.7% of AuM per individual claim seems appropriate to protect investors from damage resulting from any professional failure of the AIFM.

### *3.2.4. Operating conditions for AIFMs – general principles and conflicts of interest (Articles 16-37) - Articles 12 and 14 AIFMD*

The AIFMD requires the Commission to specify the criteria to be used by competent authorities to assess whether AIFMs comply with obligations to act honestly, with due skill, care and diligence, in the best interests of the AIFs, treat investors fairly, employ appropriate resources and procedures and take measures with regard to conflicts of interest.

This Delegated Regulation clarifies the general duty of AIFMs to act in the best interests of the AIF or the investors in the AIF and the integrity of the market. It clarifies the scope of due diligence in general and the scope of due diligence which should be applied if investments are made in assets of limited liquidity and where AIFMs are selecting and appointing counterparties and prime brokers. This Delegated Regulation sets out rules on inducements and handling of orders, including: reporting obligations in respect of execution of subscription

and redemption orders, and rules on placing orders to deal on behalf of AIFs with other entities for execution and aggregation and allocation of orders.

The Delegated Regulation specifies the types of conflicts of interest that may arise and lays down a conflicts of interests policy which includes procedures and arrangements AIFMs are expected to implement and apply in order to identify, prevent, manage, monitor and disclose conflicts of interest.

### *3.2.5. Operating conditions for AIFMs–risk management (Articles 38-45)- Article 15 AIFMD*

This Delegated Regulation lays down rules concerning the risk management system that should be established and applied by AIFMs. The system comprises the organisational structure, policies and procedures for managing the risks relevant to each AIF's investment strategy and the processes and techniques used to measure and manage those risks. In terms of organisational structure, the Regulation requires a permanent risk management function to be established and entrusts it with specific tasks, including: implementation of the risk management policy, risk monitoring and measuring the risk level and ensuring that it complies with the AIF's risk profile. The Regulation also lays down conditions for functional and hierarchical separation of the risk management function from operating units and specifies safeguards against conflicts of interest which should ensure that the risk management activities are carried out independently.

### *3.2.6. Operating conditions for AIFMs – liquidity management (Articles 46 – 49) - Article 16 AIFMD*

The AIFMD requires the AIFM to employ, for each AIF it manages, that is not an unleveraged closed-ended AIF, an appropriate liquidity management system and to adopt procedures that enable it to monitor the AIF's liquidity risk and to ensure that the liquidity profile of the AIF's investments complies with its underlying obligations.

This Delegated Regulation specifies that the liquidity management systems and procedures should allow AIFMs to apply tools and arrangements necessary to cope with illiquid assets in order to respond to redemption requests. Such arrangements may include 'special arrangements' such as 'side-pockets'. Furthermore, it is proposed that AIFMs should, where appropriate considering the nature, scale and complexity of each AIF they manage, set up suitable limits for liquidity/illiquidity of the AIF consistent with its redemption policy. AIFMs should conduct stress tests at least annually.

### *3.2.7. Operating conditions for AIFMs — investment in securitisation positions (Articles 50-56) - Article 17 AIFMD*

The provisions on investment in securitisation positions are intended to address the potential misalignment between the interests of firms that repackage loans into tradable securities and originators, on the one hand, and the AIFMs that invest in those securities, on the other hand, with a view also to achieving cross-sectorial consistency.

Article 51 lays down a requirement for retained material net economic interest as a precondition for an AIFM assuming exposure to the credit risk of a securitisation on behalf of one or more AIFs. In addition, the AIFM has to ensure that the sponsor and originator have certain features (Article 52) and the AIFM has itself to comply with a set of qualitative requirements (Article 53). Article 54 provides for corrective action if the retained net



economic interest is below the required level. To ensure cross-sectorial consistency with the corresponding provisions in Directive 2006/48/EC a grandfathering clause (Article 55) and an interpretation provision Article 56) are introduced.

### *3.2.8. Organisational requirements – general principles (Articles 57 – 66) - Article 18 AIFMD*

AIFMs are required to use, at all times, adequate and appropriate human and technical resources necessary for the proper management of AIFs, including administrative and accounting procedures and adequate internal control mechanisms. This Delegated Regulation requires AIFMs to establish a well-documented organisational structure that clearly assigns responsibilities, defines control mechanisms and ensures a good flow of information between all parties involved. When allocating functions internally, the AIFM should ensure that the governing body, the senior management and, where relevant, the supervisory function, are responsible for the AIFM's complying with its obligations under the AIFMD. AIFMs should also apply policies and procedures designed to detect any risk of failure to comply with their obligations under the AIFMD. The permanent compliance function and the permanent internal audit function should be separate and independent from other functions in order to be able to fulfil their tasks. AIFMs should also establish systems to safeguard information and ensure business continuity. When establishing these procedures and structures, AIFMs should take into account the principle of proportionality which allows procedures, mechanisms and the organisational structure to be calibrated to the nature, scale and complexity of the AIFM's business and to the nature and range of activities carried out in the course of its business.

### *3.2.9. Valuation (Articles 67-74) - Article 19 AIFMD*

The AIFM has to ensure that, for each AIF it manages, appropriate and consistent procedures are established so that a proper and independent valuation of the AIF's assets can be performed in accordance with Article 19 of the AIFMD and the applicable national and AIF rules.

Article 67 requires the AIFM to establish, maintain and implement for each AIF policies and procedures for the valuation of assets, and lays down the main features of such valuation policies and procedures. Specific rules are adopted for the use of models for valuing assets (Article 68). Article 69 spells out the principle of consistent application of valuation policies and procedures. The Delegated Regulation further lays down rules for the periodic review of valuation policies and procedures (Article 70), the review of individual values of assets (Article 71), the calculation of the net asset value per unit or share (Article 72), the professional guarantees to be provided by an external valuer (Article 73) and the frequency of valuation of assets held by open-ended AIFs (Article 74).

### *3.2.10. Delegation of AIFM functions (Article 75 - 82) - Article 20 AIFMD*

Subject to the requirements and limitations set out in Article 20, the AIFMD allows AIFMs to delegate the performance of some of their functions, essentially in order to make the conduct of business more efficient. Articles 75 to 81 of the Regulation spell out the conditions under which the AIFM is allowed to delegate taking into account the fact that an AIFM should not be prevented from acting in the best interests of its investors and retains responsibility for the delegated functions. In particular, the extent to which an AIFM is allowed to delegate is laid down in Article 82. The AIFM has at least to keep the decision making functions which are in fact its primary business role. It therefore has to perform at least functions relating to either

risk or portfolio management. The ability to manage and control the AIF would not be ensured if the AIFM was not closely involved in the decision-making of its delegates.

### *3.2.11. Depositary (Articles 83 – 102) - Article 21 AIFMD*

The Regulation contains detailed provisions about the obligations and rights of depositaries taking into account that the core function of such entities is the protection of the AIF's investors. Criteria are established, inter alia, for monitoring the cash flows of an AIF, the scope of financial instruments to be held in custody, general oversight duties, delegation of custody and liability for the loss of a financial instrument held in custody. Articles 85 and 86 of the Regulation spell out the requirements for access and flow of information which are necessary to enable the depositary to have a clear overview and effectively monitor the AIF's cash flows as provided for by Article 21(7) AIFMD. To ensure a high standard of investor protection Article 88 sets out the scope of custody. Under this Article, all financial instruments which can be registered in a financial instruments account (essentially, transferable securities, money market instruments and units in collective investment undertakings) and which belong to an AIF must be held in custody. As clarified in recital 98, assets belonging to an AIF may not be excluded from the scope of custody simply because they are subject to particular business transactions such as collateral arrangements. Therefore, should an AIF provide its assets as collateral to a collateral taker, the AIFMD requires these assets to be kept in custody as long as the AIF owns the financial instruments. In these circumstances, custody can be arranged in several ways: (1) the collateral taker is the depositary of the AIF or is appointed by the AIF's depositary as sub-custodian over the AIF's collateralised assets; (2) the AIF's depositary appoints a sub-custodian that acts for the collateral taker; or (3) the collateralised assets remain with the AIF's depositary and are 'earmarked' in favour of the collateral taker (recital 98).

Article 92 contains in particular requirements with respect to the oversight and control function of a depositary in order to enable it to properly assess and supervise the AIFM. With respect to the liability regime Articles 100-102 ensure uniform interpretation of Article 21(12) of the AIFMD. Article 21(13) of the AIFMD states that the depositary's liability shall not be affected by any delegation referred to in paragraph 11. According to the IA, this means that the depositary will be liable to return an instrument in custody if the loss of that instrument is caused by events in the operational sphere of a depositary or its appointed network of sub-custodians. In the event of insolvency of a sub-custodian, operational failures on its part (e.g. failure to implement the segregation requirement) would also give rise to the return obligation while external events, such as natural disasters, acts of public authority or government measures (e.g. market closures), would not unless it is proved that the consequences could have been avoided. To mitigate the consequences of Article 101, Article 102 lists the objective reasons for contracting a discharge of liability.

### *3.2.12. Transparency requirements and the exchange of information (Articles 103-112) - Articles 22, 23 and 24 AIFMD*

One of the main objectives of the AIFMD is to increase the transparency of an AIFM vis-à-vis investors and supervisory authorities so that they can properly assess and be aware of the risks that might be entailed in an AIF. Therefore, Articles 103 to 111 spell out the requirements of Articles 22 to 24 AIFMD, laying down minimum standards and ensuring uniform application of the AIFMD. Articles 103 to 107 outline some minimum requirements for the content of the annual report, reflecting recognised practices, accounting standards and rules. Articles 108 and 109 stipulate the content and format of the disclosure of the

information to investors and Article 110 establishes the content, format and frequency of information to be provided to the competent authorities. Article 111 determines, in particular, when an AIFM is deemed to use leverage on a substantial basis. Under this Article, an AIF would be considered to be employing leverage on a substantial basis when its exposure, calculated using the ‘commitment method’, exceeds three times its net asset value (NAV). The preferred option provides the best trade-off between adequate reporting on leverage and the administrative burden on the AIFM and the competent authorities. This threshold would also provide AIFMs with a level playing field and legal certainty as to their reporting obligations and identify the AIFM for which competent authorities are supposed to receive information on leverage.

### *3.2.13. Rules related to third countries (Articles 113-115) - Articles 34, 35, 36, 37, 40 and 42 AIFMD*

There are a number of provisions in the AIFMD that require cooperation arrangements to be established between European competent authorities and supervisory authorities from the country of origin of a non-EU AIFM or a non-EU AIF. The Delegated Regulation specifies some aspects of those cooperation arrangements in order to design a common framework to facilitate the establishment of such cooperation arrangements with third countries.

Article 113 lays down the scope, form and objectives of the cooperation arrangements. Article 114 requires cooperation arrangements to provide for such mechanisms, instruments and procedures as are necessary for the EU competent authorities to perform their duties pursuant to the AIFMD. Article 115 requires cooperation arrangements to include a data protection safeguard in line with Article 52 of the AIFMD.

### *3.2.14. Exchange of information relating to potential systemic consequences (Article 116) – Article 53 AIFMD*

Article 116 specifies the exchange of information between the competent authorities of the Member States, ESMA and the ESRB which is required under Article 53 of the AIFMD for the purpose of identifying potential systemic consequences of AIFM activity.

## **4. BUDGETARY IMPLICATION**

The tasks envisaged in this Delegated Regulation for ESMA have neither budgetary implications for the EU budget, nor for the budget of ESMA. No additional funding and no additional posts for ESMA will be therefore required in relation to this act.

**COMMISSION DELEGATED REGULATION (EU) No .../..**

**of 19.12.2012**

**supplementing Directive 2011/61/EU of the European Parliament and of the Council  
with regard to exemptions, general operating conditions, depositaries, leverage,  
transparency and supervision**

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010<sup>6</sup>, and in particular Article 3(6), Article 4(3), Article 9(9), Article 12(3), Article 14(4), Article 15(5), Article 16(3), Article 17, Article 18(2), Article 19(11), Article 20(7), Article 21(17), Article 22(4), Article 23(6), Article 24(6), Article 25(9), Article 34(2), Article 35(11), Article 36(3), Article 37(15), Article 40(11), Article 42(3) and Article 53(3) thereof,

Having regard to the opinion of the European Central Bank,

Whereas:

- (1) Directive 2011/61/EU empowers the Commission to adopt delegated acts specifying, in particular, the rules relating to calculation of the threshold, leverage, operating conditions for Alternative Investment Fund Managers (hereinafter ‘AIFMs’), including risk and liquidity management, valuation and delegation, requirements detailing the functions and duties of depositaries of Alternative Investment Funds (hereinafter ‘AIFs’), rules on transparency and specific requirements relating to third countries. It is important that all these supplementing rules begin to apply at the same time as Directive 2011/61/EU so that the new requirements imposed on AIFMs can be effectively put into operation. The provisions in this Regulation are closely interrelated, since they deal with the authorisation, ongoing operation and transparency of AIFMs which manage and, as the case may be, or market AIFs in the Union, which are inextricably linked aspects inherent to the taking up and pursuit of the asset management business. To ensure coherence between those provisions, which should enter into force at the same time, and to facilitate a comprehensive view and compact access to them by persons subject to those obligations, including investors that are

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<sup>6</sup> OJ L 174, 01.07.2011, p.1.

non-Union residents, it is desirable to include all delegated acts required by Directive 2011/61/EU in a single Regulation.

- (2) It is important to ensure that the objectives of Directive 2011/61/EU are achieved uniformly throughout the Member States, to enhance the integrity of the internal market and offer legal certainty for its participants, including institutional investors, competent authorities and other stakeholders, by adopting a Regulation. The form of a Regulation ensures a coherent framework for all market operators and is the best possible guarantee for a level playing field, uniform conditions of competition and the common appropriate standard of investor protection. Furthermore it ensures the direct applicability of detailed uniform rules concerning the operation of AIFMs, which by their nature are directly applicable and therefore require no further transposition at national level. The recourse to a regulation allows, in addition, to avoid a delayed application of Directive 2011/61/EU in the Member States.
- (3) As the Delegated Regulation specifies the tasks and responsibilities of the ‘governing body’ and of the ‘senior management’ it is important to clarify the meaning of these terms, in particular the fact that a governing body may be comprised of senior managers. Furthermore, as this Regulation introduces also the term ‘supervisory function’ the definition of the governing body should make clear that it is the body which comprises the managerial function in case the supervisory and the managerial functions are separated in accordance with national company law. Directive 2011/61/EU requires AIFMs to provide certain information to competent authorities, including the percentage of the AIF’s assets which are subject to special arrangements arising from their illiquid nature. This Regulation clarifies the meaning of special arrangements so that AIFMs know exactly what information they should provide to competent authorities.
- (4) Directive 2011/61/EU provides for a lighter regime applicable to those AIFMs who manage portfolios of AIFs whose total assets under management do not exceed the relevant thresholds. It is necessary to specify clearly how the total value of assets under management should be calculated. In this context it is essential to define the steps necessary for calculating the total value of assets, to determine clearly which assets are not included in the calculation, to clarify how the assets acquired through the use of leverage should be valued and to provide rules for handling of cases of cross-holding among AIFs managed by an AIFM.
- (5) The total value of assets under management needs to be calculated at least annually and using up-to date information. The value of assets should therefore be determined in the twelve months preceding the date of calculation of the total value of assets under management and as close as possible to such a date.
- (6) To ensure that an AIFM remains eligible to benefit from the lighter regime provided for in Directive 2011/61/EU, it should put in place a procedure making it possible to observe on an ongoing basis the total value of assets under management. The AIFM may consider the types of AIFs under management and the different classes of assets invested in order to assess the likelihood of breaching the threshold or the need for an additional calculation.
- (7) Where an AIFM no longer meets the conditions related to the thresholds it should notify its competent authority and apply for an authorisation within 30 calendar days.

However, where exceeding or falling below the thresholds occurs only occasionally within a given calendar year and such situations are considered as temporary the AIFM should not be obliged to make an application for authorisation. In those cases, the AIFM should inform the competent authority of the breach of the threshold, and explain why it considers such breach to be of a temporary nature. A situation lasting for more than three months cannot be considered as being temporary. When assessing the likelihood of a situation to be temporary, the AIFM should consider anticipated subscription and redemption activity or, where applicable, capital draw-downs and distribution. The AIFM should not use anticipated market movements as part of this assessment.

- (8) Data used by AIFMs to calculate the total value of assets under management do not need to be available to the public or to investors. However, competent authorities must be able to verify that the AIFM is correctly calculating and monitoring the total value of assets under management, including the assessment of occasions when the total value of assets under management temporarily exceeds the relevant threshold and should therefore have access to these data on request.
- (9) It is important that AIFMs benefiting from the provisions of the lighter regime in Directive 2011/61/EU provide the competent authorities with up-to-date information at the time of registration. Not all types of AIFMs may have updated offering documents reflecting the latest developments related to the AIFs they manage and such AIFMs may find it more practical to specify the required information in a separate document describing the funds' investment strategy. This could be the case of private equity or venture capital funds which often raise money through negotiations with potential investors.
- (10) An AIF which holds only equity shares in listed companies should not be regarded as being leveraged as long as the equity shares are not acquired through borrowing. Where the same AIF purchases options on an equity index, it should be regarded as being leveraged, since it has increased the exposure of the AIF to a given investment.
- (11) In order to ensure a uniform application of AIFM obligations to grant an objective overview of the leverage used, it is necessary to provide two methods to calculate the leverage. As it results from market studies, the best results can be achieved by combining the so-called 'gross' and 'commitment' methods.
- (12) In order to receive appropriate information for monitoring systemic risks and to gain a complete picture of the use of leverage by the AIFM, information about the exposure of an AIF should be provided to competent authorities and investors both on a gross and on a commitment method basis and all AIFMs should therefore calculate exposure using both the gross and the commitment method. The gross method gives the overall exposure of the AIF whereas the commitment method gives insight in the hedging and netting techniques used by the manager; therefore both methods shall be seen in conjunction. Specifically, the degree to which overall exposure differs between the gross method and the commitment method may provide useful information. If necessary to ensure that any increase of the exposure of AIFs is adequately reflected the Commission may adopt additional delegated acts on an additional and optional method for the calculation of leverage.

- (13) When calculating the exposure, all positions of the AIF should initially be included, including short and long assets and liabilities, borrowings, derivative instruments and any other method increasing the exposure where the risks and rewards of assets or liabilities are with the AIF, and all other positions that make up the net asset value.
- (14) Borrowing arrangements entered into by the AIF should be excluded if they are temporary in nature and relate to and are fully covered by capital commitments from investors. Revolving credit facilities should not be considered being temporary in nature.
- (15) In addition to calculating exposure using the gross method, all AIFMs should calculate exposure using the commitment method. According to the commitment method financial derivative instruments should be converted into equivalent positions in the underlying asset. However, if an AIF invests in certain derivatives in order to off-set the market risk of other assets in which the AIF is invested, under certain conditions, those derivatives should not be converted into an equivalent position in the underlying assets as the exposures of the two investments balance one another. That should be the case where, for instance, an AIF portfolio invests in a certain index and holds a derivative instrument which swaps the performance of that index with the performance of a different index, that should be equivalent to holding exposure to the second index in the portfolio and therefore the AIF's net asset value would not depend on the performance of the first index.
- (16) When calculating exposure according to the commitment method, derivatives which fulfil the criteria set out in this Regulation do not provide any incremental exposure. Thus, if the AIF invests in index future contracts and holds a cash position equal to the total underlying market value of future contracts, this would be equivalent to directly investing in index shares and therefore the index future contract should not be taken into account for the purpose of calculating the exposure of the AIF.
- (17) When calculating exposure according to the commitment method, AIFMs should be allowed to consider hedging and netting arrangements provided they fulfil the criteria relating to the commitment method.
- (18) The requirement that netting arrangements refer to the same underlying asset should be interpreted strictly so that assets which the AIFM considers as equivalent or highly correlated, such as different share classes or bonds issued by the same issuer, should not be considered as identical for the purposes of netting arrangements. The definition of netting arrangements aims to ensure that only those trades which offset the risks linked to other trades, leaving no material residual risk, are taken into account. Combinations of trades which aim to generate a return, however small, by reducing some risks while keeping others should not be considered as netting arrangements, as with arbitrage investment strategies which aim to generate a return by taking advantage of pricing discrepancies between derivative instruments with the same underlying but different maturities.
- (19) A portfolio management practice which aims to reduce the duration risk by combining an investment in a long-dated bond with an interest rate swap or to reduce the duration of an AIF bond portfolio by concluding a short position on bond future contracts representative of the interest rate risk of the portfolio (duration hedging) should be

considered as a hedging arrangement provided that it complies with the hedging criteria.

- (20) A portfolio management practice, which aims to offset the significant risks linked to an investment in a well diversified portfolio of shares by taking a short position on a stock market index future, where the composition of the equity portfolio is very close to that of the stock market index and its return highly correlated to that of the stock market index and where the short position on the stock market index future allows an unquestionable reduction of the general market risk related to the equity portfolio and the specific risk is insignificant, such as a beta-hedging of a well-diversified equity portfolio where the specific risk is considered to be insignificant, should be considered as complying with the hedging criteria.
- (21) A portfolio management practice which aims to offset the risk linked to an investment in a fixed interest rate bond by combining a long position on a credit default swap and an interest rate swap which swaps that fixed interest rate with an interest rate equal to an appropriate money market reference rate plus a spread should be considered as a hedging arrangement where all the hedging criteria of the commitment method are in principle complied with.
- (22) A portfolio management practice which aims to offset the risk of a given share by taking a short position through a derivative contract on a share that is different to but strongly correlated with that first share should not be considered as complying with the hedging criteria. Although such a strategy relies on taking opposite positions on the same asset class, it does not hedge the specific risk linked to the investment in a certain share. Therefore, it should not be considered as a hedging arrangement as laid down in the criteria related to the commitment method.
- (23) A portfolio management practice which aims to keep the alpha of a basket of shares (comprising a limited number of shares) by combining the investment in that basket of shares with a beta-adjusted short position on a future on a stock market index should not be considered as complying with the hedging criteria. Such a strategy does not aim to offset the significant risks linked to the investment in that basket of shares but to offset the beta (market risk) of that investment and keep the alpha. The alpha component of the basket of shares may dominate over the beta component and as such lead to losses at the level of the AIF. For that reason, it should not be considered as a hedging arrangement.
- (24) A merger arbitrage strategy is a strategy that combines a short position on a stock with a long position on another stock. Such a strategy aims to hedge the beta (market risk) of the positions and generate a return linked to the relative performance of both stocks. Similarly, the alpha component of the basket of shares may dominate over the beta component and as such lead to losses at the level of the AIF. It should not be considered as a hedging arrangement as laid down in the criteria related to the commitment method.
- (25) A strategy, which aims to hedge a long position in a stock or bond with purchased credit protection on the same issuer, relates to two different asset classes and therefore should not be considered as a hedging arrangement.



- (26) When using methods which increase the exposure of an AIF, the AIFM should observe general principles such as considering the substance of the transaction in addition to its legal form. Specifically with respect to repurchase transactions, the AIFM should consider whether the risks and rewards of the assets involved are passed or retained by the AIF. The AIFM should also look through derivative instruments or other contractual arrangements to the underlying assets to determine the possible future commitments of the AIF resulting from those transactions.
- (27) As the commitment method leads to interest rates with different maturities being considered as different underlying assets, AIFs that according to their core investment policy primarily invest in interest rate derivatives may use specific duration netting rules in order to take into account the correlation between the maturity segments of the interest rate curve. When setting out its investment policy and risk profile, an AIF should be able to define the level of the interest rate risk and consequently to determine its target duration. The AIF should take into account the predefined target duration when making its investment choices. When the portfolio duration diverges from the target duration, the strategy should not be considered as a duration netting arrangement as laid down in the criteria related to the commitment method.
- (28) The duration netting rules allow long positions to be netted with short positions whose underlying assets are different interest rates. The maturities serving as the thresholds of the maturity ranges are two years, seven years and 15 years. Within each maturity range, netting positions should be allowed.
- (29) Netting positions between two different maturity ranges should be partially allowed. Penalties have to be applied to the netted positions to allow only partial netting. They should be expressed by means of percentages relying on the average correlations between the maturity ranges for two years, five years, ten years and 30 years of the interest rate curve. The longer the difference between the maturities of the positions, the more their netting must be subject to a penalty, and therefore the percentages must increase.
- (30) Positions whose modified duration is much longer than the whole portfolio's modified duration are not in line with the investment strategy of the AIF and fully matching them should not be allowed. Thus, it should not be acceptable to match an 18 months maturity short position (set in maturity range 1) with a 10 years maturity long position (set in maturity range 3), if the target duration of the AIF is around 2 years.
- (31) When calculating the exposure, AIFs can firstly identify the hedging arrangements. The derivatives involved in these arrangements are then excluded from the global exposure calculation. AIFs should use an exact calculation in hedging arrangements. AIFs should not use duration netting rules in the hedging calculation. The duration-netting rules may be used to convert the remaining interest rate derivatives into their equivalent underlying asset positions.
- (32) Pursuant to Directive 2011/61/EU, an AIFM has to ensure that the potential professional liability risks resulting from its activities are appropriately covered either by way of additional own funds or by way of professional indemnity insurance. Uniform application of this provision requires a common understanding of the potential professional liability risks to be covered. The general specification of the risks arising from an AIFM's professional negligence should determine the features of

the relevant risk events and identify the scope of potential professional liability, including damage or loss caused by persons who are directly performing activities for which the AIFM has legal responsibility, such as the AIFM's directors, officers or staff, and persons performing activities under a delegation arrangement with the AIFM. In line with the provisions of Directive 2011/61/EU, the liability of the AIFM should not be affected by delegation or sub-delegation and the AIFM should provide adequate coverage for professional risks related to such third parties for whom it is legally liable.

- (33) To ensure a common understanding of the general specification, a list of examples should serve as benchmark for identifying potential professional liability risk events. That list should include a wide range of events resulting from negligent actions, errors or omissions, such as the loss of documents evidencing title to investments, misrepresentations, or breach of the various obligations or duties incumbent on the AIFM. It should also include the failure to prevent, by means of adequate internal control systems, fraudulent behaviour within the AIFM's organisation. Damage resulting from failure to carry out sufficient due diligence on an investment that turned out to be fraudulent would trigger the AIFM's liability for professional liability and should be appropriately covered. However, losses incurred because an investment has lost value as a result of adverse market conditions should not be covered. The list should also include valuations that are improperly carried out, which should be understood as a valuation failure breaching Article 19 of Directive 2011/61/EU and the corresponding delegated acts.
- (34) In line with their risk management obligations, AIFMs should have appropriate qualitative internal control mechanisms to avoid or mitigate operational failures, including professional liability risks. Therefore, an AIFM should have, as part of its risk management policy, adequate policies and procedures for operational risk management, appropriate to the nature, scale and complexity of its business. Such procedures and policies should in any event enable an internal loss database to be built up to serve for the purpose of assessing the operational risk profile.
- (35) To ensure that additional own funds and professional liability insurance appropriately cover potential professional liability risks, quantitative minimum benchmarks should be established for determining the proper level of coverage. Such quantitative benchmarks should be determined by the AIFM as a specific percentage of the value of portfolios of AIFs managed, calculated as the sum of the absolute value of all assets of all AIFs managed, irrespective of whether they are acquired through use of leverage or with investors' money. In this context, derivative instruments should be valued at their market price as they could be replaced at that price. As coverage through professional indemnity insurance is by nature more uncertain than coverage provided through additional own funds, different percentages should apply to the two different instruments used for covering professional liability risk.
- (36) To ensure that professional indemnity insurance is effective in covering losses that result from insured events, it should be taken out from an insurance undertaking which is authorised to provide professional indemnity insurance. This includes EU insurance undertakings and non-EU undertakings to the extent that they are permitted to provide such insurance service by Union law or by national law.

- (37) In order to allow some flexibility when devising appropriate professional indemnity insurance, it should be possible for the AIFM and the insurance undertaking to agree on a clause providing that a defined amount will be borne by the AIFM as the first part of any loss (defined excess). Where such a defined excess is agreed, the AIFM should provide own funds corresponding to the defined amount of loss to be borne by the AIFM. Such own funds should be in addition to the initial capital of the AIFM and to the own funds to be provided by the AIFM pursuant to Article 9(3) of Directive 2011/61/EU.
- (38) As a matter of principle, the adequacy of coverage through additional own funds or professional indemnity insurance should be reviewed at least once a year. However, the AIFM should have procedures in place that ensure on-going monitoring of the total value of AIF portfolios managed and on-going adjustments to the amount of coverage of professional liability risks should there be significant mismatches identified. Furthermore, the competent authority of the home Member State of an AIFM may lower or increase the minimum requirement for additional own funds, after taking into account the risk profile of the AIFM, its loss history and the adequacy of its additional own funds or professional indemnity insurance.
- (39) Directive 2011/61/EU requires AIFMs to act in the best interests of AIFs, the investors in the AIFs and the integrity of the market. AIFMs should therefore apply appropriate policies and procedures which allow them to prevent malpractices such as market timing or late trading. Market timers take advantage of out of date or stale prices for portfolio securities that impact the calculation of AIF's net asset value (NAV) or buy and redeem units of the AIF within a few days, thereby exploiting the way the AIF calculates its NAV. Late trading involves placing of orders to buy or redeem units of AIFs after a designated cut off point but the price received is the one of the cut off point. Both malpractices harm the interests of long term investors as they dilute their return and have detrimental effects on AIF's returns as they increase transaction costs and disrupt portfolio management. AIFMs should also establish appropriate procedures to ensure that the AIF is managed efficiently and should act in such a way as to prevent undue costs being charged to the AIF and its investors.
- (40) In line with the approach applied to UCITS managers, AIFMs should ensure a high standard of diligence in the selection and monitoring of investments. They should have appropriate professional expertise and knowledge of the assets in which AIFs are invested. In order to ensure that investment decisions are carried out in compliance with the investment strategy and, where applicable, risk limits of the AIFs managed, AIFMs should establish and implement written policies and procedures on due diligence. These policies and procedures should be reviewed and updated on a regular basis. When AIFMs invest in specific types of assets for a long duration, less liquid assets such as real estate or partnership interests, due diligence requirements should apply also to the negotiation phase. The activities performed by the AIFM before closing an agreement should be well documented in order to demonstrate that they are consistent with the economic and financial plan and therefore with the duration of the AIF. AIFMs should maintain minutes of the relevant meetings, the preparatory documentation and the economic and financial analysis conducted for assessing the feasibility of the project and the contractual commitment.
- (41) The requirement that AIFMs act with due skill, care and diligence should also apply where the AIFM appoints a prime broker or counterparty. The AIFM should select and

appoint only those prime brokers and counterparties, which are subject to ongoing supervision, are financially sound and have the necessary organisational structure appropriate to the services to be provided to the AIFM or the AIF. In order to ensure that investors' interests are adequately protected, it is important to clarify that one of the criteria against which financial soundness should be assessed is whether or not prime brokers or counterparties are subject to relevant prudential regulation, including adequate capital requirements, and effective supervision.

- (42) In line with Directive 2011/61/EU, which requires AIFMs to act honestly, fairly and with due skill, persons who effectively direct the business of the AIFM, who are members of the governing body or of the senior management, in the case of entities which do not have a governing body, should possess sufficient knowledge, skills and experience to exercise their tasks, in particular to understand the risks associated with the activity of the AIFM. In line with the Commission's Green Paper on corporate governance in the financial sector<sup>7</sup>, persons who effectively direct the business of the AIFM should also commit sufficient time to perform their functions in the AIFM and act with honesty, integrity and independence of mind to, inter alia, effectively assess and challenge the decisions of the senior management.
- (43) To ensure that the relevant activities are performed properly, AIFMs should employ personnel with the necessary skills, knowledge and expertise to carry out tasks assigned to them.
- (44) AIFMs that provide the service of individual portfolio management have to comply with inducement rules laid down in Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive<sup>8</sup>. For reasons of consistency, those principles should extend to AIFMs that provide the service of collective portfolio management, and marketing. The existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating the amount, should be disclosed in the AIFM's annual report.
- (45) Investors in AIFs should benefit from protection similar to that of AIFM clients to whom AIFMs provide the service of individual portfolio management, as in such a case they have to comply with the best execution rules laid down in Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC<sup>9</sup> and Directive 2006/73/EC. However, the differences between the various types of assets in which AIFs are invested should be taken into account, since best execution is not relevant, for instance, when the AIFM invests in real estate or partnership interests and the investment is made after extensive negotiations on the terms of the agreement. Where there is no choice of different execution venues, the AIFM should be able to demonstrate to the competent authorities and auditors that there is no choice of different execution venues.

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<sup>7</sup> COM(2010)284

<sup>8</sup> OJ L 241, 2.9.2006, p. 26.

<sup>9</sup> OJ L 145, 30.4.2004, p. 1.

- (46) For reasons of consistency with requirements applying to UCITS managers, rules on handling of orders and on aggregation and allocation of trading orders should apply to AIFMs when providing collective portfolio management. However, such rules should not apply where the investment in assets is made after extensive negotiations on the terms of the agreement, such as investment in real estate, partnership interests or non-listed companies as in such cases no order is executed.
- (47) It is important to specify the situations where conflicting interests are likely to occur, in particular where there is a prospect of financial gain or avoidance of financial loss or where financial or other incentives are provided to steer the behaviour of the AIFM in such a way that it favours particular interests at the expense of interests of other parties, such as another AIF, its clients, undertakings for collective investments in transferable securities (UCITS) or other clients of the AIFM.
- (48) The conflicts of interest policy established by the AIFM should identify situations in which activities carried out by the AIFM could constitute conflicts of interest that do or do not lead to potential risks of damage to the AIF's interests or the interests of its investors. To identify them the AIFM should take into account not only the activity of collective portfolio management but also other activities it is authorised to carry out, including activities of its delegates, sub-delegates, external valuer or counterparty.
- (49) In line with the approach considered in Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)<sup>10</sup> for UCITS management companies and in Directive 2004/39/EC for investment firms, AIFMs should adopt procedures and measures to ensure that relevant persons engaged in different business activities that could involve conflicts of interest carry out these activities at an independent level, appropriate to the size and activities of the AIFM.
- (50) It is essential to provide for a general framework according to which conflicts of interest, if they occur, should be managed and disclosed. The detailed steps and procedures to be followed in such situations should be clarified in the conflicts of interest policy to be established by the AIFM.
- (51) One of the central components of a risk management system is a permanent risk management function. In the interest of consistency, its tasks and responsibilities should be similar in nature to those assigned by Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company<sup>11</sup> to the permanent risk management function in UCITS management companies. This function should have a primary role in shaping the risk policy of the AIF, risk monitoring and risk measuring in order to ensure that the risk level complies on an ongoing basis with the AIF's risk profile. The permanent risk management function should have the necessary authority, access to all relevant information and regular contacts with the senior management and the governing body of the AIFM in

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<sup>10</sup> OJ L 302, 17.11.2009, p. 32.

<sup>11</sup> OJ L 176, 10.7.2010, p. 42.

order to provide them with updates so that they can take prompt remedial action where needed.

- (52) The risk management policy forms another pillar of the risk management system. That policy should be appropriately documented and should explain, in particular, measures and procedures employed to measure and manage risks, the safeguards for independent performance of the risk management function, the techniques used to manage risks and the details of the allocation of responsibilities within the AIFM for risk management and operating procedures. In order to ensure its effectiveness, the risk management policy should be reviewed at least annually by the senior management.
- (53) As required by Directive 2011/61/EU, the function of risk management should be functionally and hierarchically separated from the operating units. It should thus be clarified that such separation should be ensured up to the governing body of the AIFM and that those in the risk management function should not carry out any conflicting tasks or be supervised by someone who is in charge of conflicting functions.
- (54) It is essential to specify the safeguards to be employed by the AIFM in any event in order to ensure the independent performance of the risk management function, and in particular, that those performing the risk management function should not be entrusted with conflicting duties, that they should make decisions on the basis of the data which they can appropriately assess and that the decision making process should be capable of being reviewed.
- (55) Although Directive 2011/61/EU does not impose any investment restrictions on AIFs, the risks incurred by each AIF cannot be managed effectively if the risk limits have not been set in advance by AIFMs. The risk limits should be in line with the risk profile of the AIF, and should be disclosed to investors in accordance with Directive 2011/61/EU.
- (56) For consistency reasons, the requirements relating to identification, measuring and monitoring of risk are built on similar provisions of Directive 2010/43/EU. AIFMs should deal appropriately with the possible vulnerability of their risk measurement techniques and models by carrying out stress tests, back tests and scenario analysis. Where stress tests and scenario analysis reveal particular vulnerability to a given set of circumstances, AIFMs should take prompt steps and corrective actions.
- (57) Directive 2011/61/EU requires the Commission to specify the liquidity management systems and procedures enabling the AIFM to monitor the liquidity risk of the AIF, except where the AIF is an un-leveraged closed-ended AIF, and ensure that the liquidity profile of the AIF's investments complies with its underlying obligations. Therefore, it is important to set out fundamental general requirements addressed to all AIFMs, the application of which should be adapted to the size, structure and nature of the AIFs managed by the AIFM concerned.
- (58) AIFMs should be able to demonstrate to their competent authorities that appropriate and effective liquidity management policies and procedures are in place. That requires due consideration to be given to the nature of the AIF, including the type of underlying assets and the amount of liquidity risk to which the AIF is exposed, the scale and complexity of the AIF or the complexity of the process to liquidate or sell assets.

- (59) Liquidity management systems and procedures can allow AIFMs to apply the tools and arrangements necessary to cope with illiquid assets and related valuation problems in order to respond to redemption requests. Such tools and arrangements may include, where allowed under national law, gates, partial redemptions, temporary borrowings, notice periods and pools of liquid assets. ‘Side pockets’ and other mechanisms where certain assets of the AIF are subject to similar arrangements between the AIF and its investors should be regarded as ‘special arrangements’ as they impact the specific redemption rights of investors in the AIF. The suspension of an AIF should not be considered as a special arrangement as this applies to all of the AIF’s assets and all of the AIF’s investors. The use of tools and special arrangements to manage liquidity should be made dependent on concrete circumstances and should vary according to the nature, scale and investment strategy of the AIF.
- (60) The requirement to monitor the liquidity management of underlying collective investment undertakings in which AIFs invest, along with the requirements to put in place tools and arrangements to manage liquidity risk and identify, manage and monitor conflicts of interest between investors should not apply to AIFMs managing AIFs of the closed-ended type regardless of whether they are deemed to be employing leverage. The exemption from those redemption-related liquidity management requirements should reflect the differences in the general redemption terms of investors in a closed-ended AIF compared to those in an open-ended AIF.
- (61) The use of minimum limits regarding the liquidity or illiquidity of the AIF could provide an effective monitoring tool for certain types of AIFMs. Exceeding a limit may not of itself require action by the AIFM as this depends on the facts and circumstances and the tolerances set by the AIFM. Limits could thus be used in practice in relation to monitoring average daily redemption versus fund liquidity in terms of days over the same period. That could also be used to monitor investor concentration to support stress testing scenarios. Those limits could provide triggers for continued monitoring or remedial action depending on the circumstances.
- (62) The stress tests should, where appropriate, simulate shortage of liquidity of the assets as well as atypical redemption requests. Recent and expected future subscriptions and redemptions should be taken into consideration together with the impact of anticipated AIF performance relative to peers on such activity. The AIFM should analyse the period of time required to meet redemption requests in the stress scenarios simulated. The AIFM should also conduct stress tests on market factors such as foreign exchange movements which could materially impact the credit profile of the AIFM or that of the AIF and as a result collateral requirements. The AIFM should account for valuation sensitivities under stressed conditions in its approach to stress testing or scenario analysis.
- (63) The frequency with which stress tests should be conducted should depend on the nature of the AIF, the investment strategy, liquidity profile, type of investor and redemption policy of the AIF. However, it is expected that those tests will be conducted at least on an annual basis. Where stress tests suggest significantly higher than expected liquidity risk, the AIFM should act in the best interest of all AIF investors taking into consideration the liquidity profile of the AIF’s assets, the level of redemption requests and where appropriate the adequacy of the liquidity management policies and procedures.

- (64) Directive 2011/61/EU requires the Commission to specify how the investment strategy, liquidity profile and redemption policy are to be aligned. The consistency between those three elements is ensured if investors are able to redeem their investments in accordance with the AIF redemption policy, which should cover conditions for redemption in both normal and exceptional circumstances, and in a manner consistent with the fair treatment of investors.
- (65) Directive 2011/61/EU requires cross-sectoral consistency and the removal of misalignment between the interests of originators that repackage loans into tradable securities and AIFMs that invest in those securities or other financial instruments on behalf of AIFs. To achieve that aim, the relevant provisions of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006<sup>12</sup> relating to the taking up and pursuit of the business of credit institutions that lay down the quantitative and qualitative requirements to be met by investors exposed to the credit risk of a securitisation, by originators and by sponsors have been taken into account. As the same objective of aligning the interests of the originator or sponsor and the interests of investors are pursued by this Regulation and the relevant provisions of Directive 2006/48/EC it is essential that the terminology is used consistently in both legal acts, therefore the definitions given in Directive 2006/48/EC are taken as reference. Given that the Committee of European Banking Supervisors, the predecessor of the European Banking Authority, has provided detailed Guidelines for interpreting the relevant provisions of Directive 2006/48/EC<sup>13</sup>, achieving cross-sectoral consistency requires the current provisions seeking to align interests between originators, sponsors and AIFMs to be interpreted in light of those Guidelines.
- (66) It is important that transactions that re-package loans into tradable securities are not structured in such a way as to avoid the application of the requirements relating to investments in securitisation positions. Therefore, the reference to an investment in tradable securities or other financial instruments based on repackaged loans should not be interpreted strictly as a legally valid and binding transfer of title with respect to such instruments, but as an investment made in a material economic sense so that any other forms of synthetic investments should be covered and subject to the specific requirements. To avoid misunderstandings and align the language with that used in the banking legislation, the terms ‘assumption of exposure to the credit risk of a securitisation’ should be used instead of ‘investment in tradable securities or other financial instruments based on repackaged loans’.
- (67) The requirements that need to be met by institutions acting as originators, sponsors or original lenders of a securitisation are directly imposed on them by way of Directive 2006/48/EC. It is therefore important to prescribe the corresponding duties of an AIFM assuming exposure to securitisations. Consequently, the AIFM should assume exposure to securitisations only if the originator, sponsor or original lender has explicitly disclosed to the AIFM the retention of a significant economic interest in the underlying asset, known as retention requirement. Furthermore, the AIFM should

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<sup>12</sup> OJ L177, 30.6.2006

<sup>13</sup> Committee of European Banking Supervisors, Guidelines to Article 122a of the Capital Requirements Directive of 31 December 2010, <http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Application%20of%20Art.%20122a%20of%20the%20CRD/Guidelines.pdf>.



ensure that various qualitative requirements imposed on the sponsor and originator through Directive 2006/48/EC are met. In addition, the AIFM should itself meet qualitative requirements in order to have a comprehensive and thorough understanding of the securitisation investment and its underlying exposure. To achieve that, AIFMs should make their investment decision only after having conducted careful due diligence from which they should have adequate information on and knowledge of the securitisations concerned.

- (68) There are circumstances in which entities meet the definition of originator or sponsor, or fulfil the role of original lender; however, another entity that neither meets the definition of sponsor or originator, nor fulfils the role of original lender — but whose interests are most optimally aligned with those of investors — may seek to fulfil the retention requirement. For the sake of legal certainty, such other entity should not be required to fulfil the retention requirement if the retention requirement is fulfilled by the originator, sponsor or original lender.
- (69) In case of a breach of the retention requirement or the qualitative requirements the AIFM should consider taking some corrective action, such as hedging, selling or reducing the exposure or approaching the party in breach of the retention requirement with a view to reinstating compliance. Such corrective action should always be in the interest of the investors and should not involve any direct obligation to sell the assets immediately after the breach has become apparent, therefore avoiding a ‘fire sale’. The AIFM should take the breach into account when considering making another investment in a further transaction in which the party in breach of the requirement is involved.
- (70) In order to comply with the requirements of Directive 2011/61/EU to specify internal procedures and organisational arrangements, which each AIFM should apply, AIFMs should be required to establish a well-documented organisational structure that clearly assigns responsibilities, defines control mechanisms and ensures a good flow of information between all parties involved. AIFMs should also establish systems to safeguard information and ensure business continuity. When establishing those procedures and structures, AIFMs should take into account the principle of proportionality which allows procedures, mechanisms and organisational structure to be calibrated to the nature, scale and complexity of the AIFM’s business and to the nature and range of activities carried out in the course of its business.
- (71) Disclosure to investors is of paramount importance to protect those investors, so AIFMs should implement appropriate policies and procedures to ensure that the redemption terms applicable to a particular AIF are disclosed in sufficient detail and with sufficient prominence to investors before they invest and in the event of material changes. That could include disclosure of notice periods in relation to redemptions, details of lock-up periods, an indication of circumstances in which normal redemption mechanisms might not apply or may be suspended, and details of any measures that may be considered by the governing body, such as gates, side pocketing, as they have an impact on the specific redemption rights of investors in the particular AIF.
- (72) To ensure that the relevant activities are performed properly, AIFMs, in particular, should use suitable electronic systems in order to fulfil the recording requirements with regard to portfolio transactions or subscription and redemption orders and establish, implement and maintain accounting policies and procedures to ensure that

the calculation of the net asset value is carried out as required in Directive 2011/61/EU and this Regulation.

- (73) In order to ensure consistency with the requirements imposed on UCITS managers by Directive 2009/65/EC, the governing body, the senior management, or, where relevant the supervisory function of the AIFM should be entrusted with similar types of tasks to which adequate responsibilities should be allocated. However, such allocation of responsibilities should be consistent with the role and responsibilities of the governing body, the senior management and the supervisory function under applicable national law. Senior management may include some or all of the members of the governing body.
- (74) The requirement to establish a permanent and effective compliance function should always be fulfilled by the AIFM, irrespective of the size and complexity of its business. However, details of the technical and personnel organisation of the compliance function should be calibrated to the nature, scale and complexity of the AIFM's business and the nature and range of its services and activities. The AIFM should not have to establish an independent compliance unit if such a requirement would be disproportionate in view of the size of the AIFM or the nature, scale and complexity of its business.
- (75) Valuation standards differ across jurisdictions and asset classes. This Regulation should supplement the common general rules and establish benchmarks for AIFMs when developing and implementing appropriate and consistent policies and procedures for the proper and independent valuation of the assets of AIFs. The policies and procedures should describe the obligations, roles and responsibilities pertaining to all parties involved in the valuation, including external valuers.
- (76) The value of assets can be determined, in different ways, such as by reference to observable prices in an active market or by an estimate using other valuation methodologies according to national law, the AIF rules or its instruments of incorporation. As the value of individual assets and liabilities can be determined by different methodologies and can be taken from different sources, the AIFM should determine and describe the valuation methodologies it uses.
- (77) Where a model is used for valuing assets, the valuation procedures and policies should indicate the main features of the model. Before it is used, that model should be subject to a validation process conducted by an internal or external individual who was not involved in the process of building the model. A person should be considered qualified to conduct a validation process in respect of the model used to value assets if he is in possession of adequate competence and experience in the valuation of assets using such models; such person could be an auditor.
- (78) Since AIFs operate in a dynamic environment where investment strategies may change over time, valuation policies and procedures should be reviewed at least yearly and in any event before AIFs engage with a new investment strategy or a new type of asset. Any change in the valuation policies and procedures, including the valuation methodologies, should follow a predetermined process.
- (79) The AIFM has to ensure that the individual assets of an AIF have been valued properly, in line with the valuation policies and procedures. For some assets,

especially complex and illiquid financial instruments, there is a higher risk of inappropriate valuation. To address this type of situation, the AIFM should put in place sufficient controls to ensure that an appropriate degree of objectivity can be attached to the value of the AIF's assets.

- (80) Calculation of the net asset value per unit or share is subject to national law and, as the case may be, or the fund rules or instruments of incorporation. This Regulation covers only the procedure for the calculation, and not the methodology of the calculation. The AIFM may itself carry out the calculation of the net asset value per unit or share as part of the administration functions it performs for the AIF. Alternatively, a third party may be appointed to perform administration, including calculation of the net asset value. A third party that carries out the calculation of the net asset value for an AIF should not be considered an external valuer for the purposes of Directive 2011/61/EU, as long as it does not provide valuations for individual assets, including those requiring subjective judgement, but incorporates into the calculation process values which are obtained from the AIFM, pricing sources or an external valuer.
- (81) There are valuation procedures that can be performed on a daily basis such as the valuation of financial instruments, but there are also valuation procedures that cannot be carried out with the same frequency as issues, subscriptions, redemptions and cancellations take place, for instance the valuation of real estate. The frequency of valuation of the assets held by an open-ended fund should take into account the differences in the valuation procedures with respect to the types of assets held by the AIF.
- (82) The strict requirements and limitations which have to be complied with when an AIFM intends to delegate the task of carrying out functions are set out in Directive 2011/61/EU. The AIFM remains at all times fully responsible for the proper performance of the delegated tasks and their compliance with Directive 2011/61/EU and its implementing measures. The AIFM should therefore ensure that the delegate performs and applies the quality standards which would be applied by the AIFM itself. Also, if necessary to ensure that delegated functions are performed to a consistently high standard, the AIFM has to be able to terminate the delegation and the delegation arrangement should therefore confer flexible termination rights on the AIFM. The delegation limitations and requirements should apply to the management functions set out in Annex I of Directive 2011/61/EU, whereas supporting tasks like administrative or technical functions assisting the management tasks such as logistical support in the form of cleaning, catering and procurement of basic services or products, should not be deemed to constitute delegation of AIFM functions. Other examples of technical or administrative functions are buying standard software 'off-the-shelf' and relying on software providers for ad hoc operational assistance in relation to off-the-shelf systems or providing human resources support such as sourcing of temporary employees or processing of payroll.
- (83) To ensure a high level of investor protection in addition to the increase of the efficiency of the conduct of the business of the AIFM the entire delegation should be based on objective reasons. When assessing these reasons, competent authorities should consider the structure of the delegation and its impact on the structure of the AIFM and the interaction of the delegated activities with the activities remaining with the AIFM

- (84) In order to assess whether the person who effectively conducts the business of the delegate is of sufficiently good repute, the person's conduct of business should be verified as well as whether he has committed offences regarding financial activities. Any other relevant information concerning personal qualities which might adversely affect the person's conduct of business such as doubts in relation to his honesty and integrity should be considered when assessing the requirement of sufficient good repute.
- (85) Investment companies authorised under Directive 2009/65/EC are not deemed to be undertakings which are authorised or registered for the purposes of asset management and subject to supervision because they are not allowed to engage in activities other than collective portfolio management under that Directive. Similarly, an internally managed AIF should not be deemed to be classified as such an undertaking because it should not engage in activities other than the internal management of the AIF.
- (86) Where the delegation concerns portfolio management or risk management, which are the core business of the AIFM and therefore of high relevance with respect to investor protection and systemic risk, in addition to the requirements of Article 20(1)(c) of Directive 2011/61/EU the competent authority of the home Member State of the AIFM and the supervisory authority of the third country undertaking should have concluded a cooperation arrangement based on a written agreement. The arrangement should be in place prior to the delegation. The details of this agreement should take international standards into consideration.
- (87) Written arrangements should confer on competent authorities the right to carry out on-site inspections, including where they request the third-country supervisory authority of the undertaking, to which functions were delegated, to carry out on-site inspections and where they request permission from the third-country supervisory authority to carry out the inspection themselves, or to accompany staff of the third-country supervisory authority in order to assist them in carrying out on-site inspections.
- (88) Based on the obligations laid down in Directive 2011/61/EU, AIFMs should always act in the best interests of the AIFs or the investors in the AIFs they manage. Therefore, delegation should be admissible only if it does not prevent the AIFM from acting or managing the AIF in the best interests of the investors.
- (89) To maintain a high standard of investor protection possible conflicts of interest have to be taken into account for any delegation. Several criteria should set benchmarks for identifying situations which would result in a material conflict of interest. Those criteria should be understood as non-exhaustive and meaning that non-material conflicts of interest are also relevant for the purposes of Directive 2011/61/EU. Thus, the carrying out of compliance or audit functions should be deemed as conflicting with portfolio management tasks, whereas market making or underwriting should be understood as conflicting with portfolio or risk management. That obligation is without prejudice to the obligation of the delegate to separate functionally and hierarchically the tasks of portfolio and risk management from each other according to the provisions of Article 15 of Directive 2011/61/EU.
- (90) The requirements applying to the delegation of the task of carrying out functions on behalf of the AIFM should apply *mutatis mutandis* where the delegate sub-delegates any of the functions delegated to it and also in the case of any further sub-delegation.

- (91) To ensure that in any event the AIFM performs investment management functions, the AIFM should not delegate its functions to the extent that, in essence, it can no longer be considered to be the manager of the AIF and to the extent that it becomes a letter-box entity. The AIFM should at all times keep sufficient resources to supervise the delegated functions efficiently. The AIFM has to perform itself investment management functions, to have the necessary expertise and resources, to keep the power to take decisions which fall under senior management responsibility and to perform senior management functions, which could include implementation of the general investment policy and investment strategies.
- (92) The assessment of a delegation structure is a complex exercise that has to be based on a series of criteria in order for the competent authorities to form their judgement. The combination is necessary to take into account the variety of fund structures and investment strategies across the Union. ESMA may develop guidelines to ensure a consistent assessment of delegation structures across the Union.
- (93) The Commission shall monitor how the criteria are applied and their impact on the markets. The Commission shall review the situation after two years and, should it prove necessary, shall take appropriate measures to further specify the conditions under which the AIFM shall be deemed to have delegated its functions to such an extent that it becomes a letter box entity and can no longer be considered to be the manager of the AIF.
- (94) Directive 2011/61/EU lays down an extensive set of requirements regarding the depositary of an AIF in order to ensure a high standard of investor protection. The respective concrete rights and obligations of the depositary, the AIFM and, as the case may be, or the AIF and third parties should therefore be set out clearly. The written contract should comprise all details necessary for the appropriate safe-keeping of all the AIF's assets by the depositary or a third party to whom safe-keeping functions are delegated in accordance with Directive 2011/61/EU and for the depositary to properly fulfil its oversight and control functions. In order to allow the depositary to assess and monitor custody risk, the contract should provide sufficient detail on the categories of assets in which the AIF may invest and cover the geographical regions in which the AIF plans to invest. The contract should also contain details of an escalation procedure. Thus, the depositary should alert the AIFM to any material risk identified in a particular market's settlement system. With respect to the termination of the contract, it should reflect the fact that the termination of the contract is the depositary's last resort if it is not satisfied that the assets are sufficiently protected. It should also prevent moral hazard whereby the AIFM would make investment decisions irrespective of custody risks on the basis that the depositary would be liable in most cases. In order to maintain a high standard of investor protection, the requirement laying down the details for the monitoring of third parties should be applied in relation to the whole custody chain.
- (95) A depositary established in a third country should be subject to public prudential regulation and to prudential supervision performed by a supervisory authority which is competent for on-going supervision, undertaking investigations and imposing sanctions. Where that supervision of the depositary involves multiple supervisory authorities, one supervisory authority should act as the contact point for the purposes of Directive 2011/61/EU and all delegated and implementing measures adopted pursuant to it.

- (96) The assessment of the law of the third country according to Article 21(6) last subparagraph of Directive 2011/61/EU should be made by the European Commission by comparing the authorisation criteria and the on-going operating conditions applicable to the depositary in the third country with the corresponding requirements applicable under Union law to credit institutions and, as the case may be, or to investment firms for access to the depositary business and performance of the depositary functions, with a view to ascertaining whether the local criteria have the same effect as those established under Union law. A depositary which is subject to prudential oversight and licensed in the third country under a local category other than a credit institution or an investment firm may be assessed by the European Commission with a view to ascertaining whether the relevant provisions of the law of the third country have the same effect as those established by the law of the Union for credit institutions and, as the case may be, or for investment firms.
- (97) In order for the depositary to have a clear overview of all inflows and outflows of cash of the AIF in all instances, the AIFM should ensure that the depositary receives without undue delay accurate information related to all cash flows, including from any third party with which an AIF's cash account is opened.
- (98) In order for the AIF's cash flows to be properly monitored the depositary's obligation consists of making sure that there are procedures in place and effectively implemented to appropriately monitor the AIF's cash flows and that these procedures are periodically reviewed. In particular, the depositary should look into the reconciliation procedure to satisfy itself that the procedure is suitable for the AIF and performed at appropriate intervals taking into account the nature, scale and complexity of the AIF. Such a procedure should for example compare one by one each cash flow as reported in the bank account statements with the cash flows recorded in the AIF's accounts. Where reconciliations are performed on a daily basis as for most open-ended AIFs, the depositary should perform its reconciliation also on a daily basis. The depositary should in particular monitor the discrepancies highlighted by the reconciliation procedures and the corrective measures taken in order to notify without undue delay the AIFM of any anomaly which has not been remedied and to conduct a full review of the reconciliation procedures. Such a review should be performed at least once a year. The depositary should also identify on a timely basis significant cash flows and in particular those which could be inconsistent with the AIF's operations, such as changes in positions in AIF's assets or subscriptions and redemptions, and it should receive periodically cash account statements and check the consistency of its own records of cash positions with those of the AIFM. The depositary should keep its record up to date in accordance with Article 21(8)(b) of Directive 2011/61/EU.
- (99) The depositary has to ensure that all payments made by or on behalf of investors upon the subscription of shares or units of an AIF have been received and booked in one or more cash accounts in accordance with Directive 2011/61/EU. The AIFM should therefore ensure that the depositary is provided with the relevant information it needs to properly monitor the receipt of investors' payments. The AIFM has to ensure that the depositary obtains this information without undue delay when the third party receives an order to redeem or issue shares or units of an AIF. The information should therefore be transmitted at the close of the business day from the entity which is responsible for the subscription and redemption of shares or units of an AIF to the depositary in order to avoid any misuse of investors' payments

- (100) Depending on the type of assets to be safe-kept, assets are either to be held in custody, as with financial instruments which can be registered in a financial instruments account, or which can be physically delivered to the depositary in accordance with Directive 2011/61/EU, or to be subject to ownership verification and record-keeping. The depositary should hold in custody all financial instruments of the AIF or of the AIFM acting on behalf of the AIF that could be registered or held in an account directly or indirectly in the name of the depositary or a third party to whom custody functions are delegated, notably at the level of the central securities depositary. In addition to these situations those financial instruments are to be held in custody that are only directly registered with the issuer itself or its agent in the name of the depositary or a third party to whom custody functions are delegated. Those financial instruments that in accordance with applicable national law are only registered in the name of the AIF with the issuer or its agent, such as investments in non-listed companies by private equity and venture capital funds, should not be held in custody. All financial instruments which could be physically delivered to the depositary should be held in custody. Provided that the conditions on which financial instruments are to be held in custody are fulfilled, financial instruments which are provided as collateral to a third party or are provided by a third party for the benefit of the AIF have to be held in custody too by the depositary itself or by a third party to whom custody functions are delegated as long as they are owned by the AIF or the AIFM acting on behalf of the AIF. Also, financial instruments owned by the AIF or by the AIFM on behalf of the AIF, for which the AIF, or the AIFM on behalf of the AIF, has given its consent to re-use by the depositary, remain in custody as long as the right of re-use has not been exercised.
- (101) Financial instruments which are held in custody should be subject to due care and protection at all times. To ensure that the custody risk is properly assessed, in exercising due care, the depositary should in particular know which third parties constitute the custody chain, ensure that the due-diligence and segregation obligations have been maintained throughout the whole custody chain, ensure that it has an appropriate right of access to the books and records of third parties to whom custody functions are delegated, ensure compliance with these requirements, document all of these duties and make these documents available to and report to the AIFM.
- (102) In order to avoid circumvention of the requirements of Directive 2011/61/EU, the depositary should apply the safe-keeping duties to the underlying assets of financial structures and, as the case may be, or legal structures controlled directly or indirectly by the AIF or by the AIFM acting on behalf of the AIF. That look-through provision should not apply to funds of funds or master-feeder structures provided they have a depositary which safe-keeps the fund's assets appropriately.
- (103) The depositary should at all times have a comprehensive overview of all assets that are not financial instruments to be held in custody. Those assets would be subject to the obligation to verify the ownership and maintain a record under Directive 2011/61/EU. Examples of such assets are physical assets which do not qualify as financial instruments under Directive 2011/61/EU or could not be physically delivered to the depositary, financial contracts such as derivatives, cash deposits or investments in privately held companies and interests in partnerships.
- (104) To achieve a sufficient degree of certainty that the AIF or the AIFM acting on behalf of the AIF is indeed the owner of the assets, the depositary should make sure it

receives all information it deems necessary to be satisfied that the AIF or the AIFM acting on behalf of the AIF holds the ownership right over the asset. That information could be a copy of an official document evidencing that the AIF or the AIFM acting on behalf of the AIF is the owner of the asset or any formal and reliable evidence that the depositary considers appropriate. If necessary, the depositary should request additional evidence from the AIF or the AIFM or as the case may be from a third party.

- (105) The depositary should keep a record of all assets for which it is satisfied that the AIF holds ownership. It may set up a procedure to receive information from third parties, whereby procedures which ensure that the assets could not be transferred without the depositary or the third party to whom safe-keeping functions are delegated having been informed of such transactions may be feasible in the case of AIFs with infrequent transactions and, as the case may be, or transactions which are subject to pre-settlement negotiation. The requirement to have access to documentary evidence of each transaction from a third party could be appropriate for AIFs with more frequent portfolio trading, such as investments in listed derivatives.
- (106) In order to ensure that the depositary is able to conduct its duties, it is necessary to clarify the tasks provided for in Article 21(9) of Directive 2011/61/EU, and in particular the second layer controls to be undertaken by the depositary. Such tasks should not prevent the depositary from conducting ex-ante verifications where it deems appropriate, and in agreement with the AIFM. In order to ensure that it is able to conduct its duties, the depositary should establish its own escalation procedure to address situations where irregularities have been detected. That procedure should ensure the notification of competent authorities of any material breaches. The oversight responsibilities of the depositary towards third parties specified by this Regulation are without prejudice to the responsibilities incumbent on the AIFM under Directive 2011/61/EU.
- (107) The depositary should check the consistency between the number of units or shares issued and the subscription proceeds received. Moreover, to ensure that payments made by investors upon subscription have been received, the depositary should further ensure that another reconciliation is conducted between the subscription orders and the subscription proceeds. The same reconciliation should be performed with regard to redemption orders. The depositary should also verify that the number of units or shares in the AIF's accounts matches the number of outstanding units or shares in the AIF's register. The depositary should adapt its procedures accordingly, taking into account the frequency of subscriptions and redemptions.
- (108) The depositary should take all necessary steps to ensure that appropriate valuation policies and procedures for the assets of the AIF are effectively implemented, through the performance of sample checks or by comparing the consistency of the change in the NAV calculation over time with that of a benchmark. When setting up its procedures, the depositary should have a clear understanding of the valuation methodologies used by the AIFM or the external valuer to value the AIF's assets. The frequency of such checks should be consistent with the frequency of the AIF's asset valuation.
- (109) By virtue of its obligation of oversight under Directive 2011/61/EU, the depositary should set up a procedure to verify on an ex-post basis the AIF's compliance with



applicable law and regulations and its rules and instruments of incorporation. This covers areas such as checking that the AIF's investments are consistent with its investment strategies as described in the AIF's rules and offering documents and ensuring that the AIF does not breach its investment restrictions, if any. The depositary should monitor the AIF's transactions and investigate any unusual transactions. If the limits or restrictions set out in the applicable national law or regulations or the AIF rules and instruments of incorporation are breached, the depositary should, for example, obtain an instruction from the AIFM to reverse the transaction that was in breach at its own costs. This Regulation does not prevent the depositary from adopting an *ex ante* approach where it deems it appropriate and in agreement with the AIFM.

- (110) The depositary should ensure that the income is calculated accurately in accordance with Directive 2011/61/EU. In order to achieve this the depositary has to ensure that the income distribution is appropriate and, where it identifies an error, that the AIFM takes appropriate remedial action. Once the depositary has ensured this, it should verify the completeness and accuracy of the income distribution and in particular of the dividend payments.
- (111) When delegating safe-keeping functions related to other assets according to Directive 2011/61/EU, delegation is likely to concern administrative functions in most cases. Where the depositary delegates record-keeping functions, it would therefore be required to implement and apply an appropriate and documented procedure to ensure that the delegate complies with the requirements of Article 21(11)(d) of Directive 2011/61/EU at all times. In order to ensure a sufficient level of protection of assets, it is necessary to set out certain principles that should be applied in relation to the delegation of safekeeping. For the delegation of custody duties it is important to set out some key principles which have to be effectively applied throughout the delegation process. Those principles should not be taken to be exhaustive, either in terms of setting out all details of the depositary's exercise of due skill care and diligence, or in terms of setting out all the steps that a depositary should take in relation to these principles themselves. The obligation to monitor on an on-going basis the third party, to whom safekeeping functions have been delegated should consist of verifying that this third party correctly performs all the delegated functions and complies with the delegation contract. The third party should act honestly, in good faith with a view to the best interests of the AIF and its investors, in compliance with regulatory and supervisory requirements, and should exercise care, diligence and skill that are normally expected from a highly prudent operator of that financial profession in comparable circumstances. The depositary should review *inter alia* elements assessed during the selection and appointment process and put these elements into perspective by comparing them with the development of the market. The form of the regular review should reflect circumstances, so that the depositary is in a position to appropriately assess the risks related to the decision to entrust assets to the third party. The frequency of the review should be adapted so as to always remain consistent with market conditions and associated risks. For the depositary to effectively respond to a possible insolvency of the third party, it should undertake contingency planning, including the design of alternative strategies and the possible selection of alternative providers as may be relevant. While such measures may reduce the custody risk faced by a depositary, they do not alter the obligation to return the financial instruments or pay the corresponding amount should they be lost, which depends on whether or not the requirements of Article 21(12) of Directive 2011/61/EU are fulfilled.

- (112) When delegating safe-keeping functions, the depositary should ensure that the requirements of Article 21(11)(d)(iii) of Directive 2011/61/EU are fulfilled and that the assets of the AIF clients of the depositary are properly segregated. This obligation should particularly ensure that assets of the AIF are not lost due to insolvency of the third party to whom safekeeping functions are delegated. In order to minimise that risk in countries where the effects of segregation are not recognised by insolvency law, the depositary should take further steps. The depositary could make a disclosure to the AIF and the AIFM acting on behalf of the AIF so that such aspects of the custody risk are properly taken into account in the investment decision or take such measures as are possible in the local jurisdictions to make the assets as insolvency-proof as possible according to local law. Furthermore, the depositary could prohibit temporary deficits in client assets, use buffers or put in place arrangements prohibiting the use of a debit balance for one client to offset a credit balance for another. While such measures may reduce the custody risk faced by a depositary when delegating custody functions, they do not alter the obligation to return the financial instruments or pay the corresponding amount where these are lost, which depends on whether or not the requirements of Directive 2011/61/EU are fulfilled.
- (113) The depositary's liability under Article 21(12) second subparagraph of Directive 2011/61/EU is triggered in the event of the loss of a financial instrument held in custody by the depositary itself or by a third party to whom the custody has been delegated, provided that the depositary does not demonstrate that the loss results from an external event beyond reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. That loss should be distinguished from an investment loss for investors resulting from a decrease in the value of assets as a consequence of an investment decision.
- (114) To be ascertained as such, it is important that the loss is definitive, and there is no prospect of recovering the financial asset. Thus, situations where a financial instrument is only temporarily unavailable or frozen should not count as losses within the meaning of Article 21(12) of Directive 2011/61/EU. In contrast, three types of situations can be identified where the loss should be deemed to be definitive: where the financial instrument no longer exists or never did exist; where the financial instrument exists but the AIF has definitively lost its right of ownership over it; and where the AIF has the ownership right but can no longer transfer title of or create limited property rights in the financial instrument on a permanent basis.
- (115) A financial instrument is deemed no longer to exist for instance when it has disappeared following an accounting error that cannot be corrected, or if it never existed, when the AIF's ownership was registered on the basis of falsified documents. Situations where the loss of financial instruments is caused by fraudulent conduct should be deemed a loss.
- (116) No loss can be ascertained when the financial instrument has been substituted by or converted into another financial instrument, for example in situations where shares are cancelled and replaced by the issue of new shares in a company reorganisation. An AIF should not be considered as permanently deprived of its right of ownership over the financial instrument if the AIF or the AIFM acting on behalf of the AIF has legitimately transferred ownership to a third party. Where there is a distinction between the legal ownership and the beneficial ownership of the assets, the definition of loss should refer to loss of the beneficial ownership right.

- (117) Only in the case of an external event beyond the reasonable control of the depositary, the consequences of which are unavoidable despite all reasonable efforts to the contrary, could the depositary avoid to be held liable under Article 21(12) of Directive 2011/61/EU. The cumulative fulfilment of these conditions should be proven by the depositary in order for it to be discharged of liability.
- (118) It should first be determined whether the event which led to the loss was external. The depositary's liability should not be affected by delegation and therefore an event should be deemed external if it does not occur as a result of any act or omission of the depositary or the third party to whom the custody of financial instruments held in custody has been delegated. Then, it should be assessed whether the event is beyond the reasonable control, by verifying that there was nothing a prudent depositary could reasonably have done to prevent the occurrence of the event. Under these steps both natural events and acts of a public authority may be considered as external events beyond reasonable control. Thus, in the context of the insolvency of a third party to whom custody was delegated, the law of the country where the instruments are held in custody, which does not recognise the effects of an appropriately implemented segregation, is deemed to be an external event beyond reasonable control. In contrast, a loss caused by failure to apply the segregation requirements laid down in Article 21(11) (d) (iii) of Directive 2011/61/EU or the loss of assets because of disruption in the third party's activity in relation to its insolvency cannot be seen as being external events beyond reasonable control.
- (119) Finally, the depositary should prove that the loss could not have been avoided despite all reasonable efforts to the contrary. In this context, the depositary should inform the AIFM and take appropriate action depending on the circumstances. For instance, in a situation where the depositary believes the only appropriate action is to dispose of the financial instruments, the depositary should duly inform the AIFM, which must in turn instruct the depositary in writing whether to continue holding the financial instruments or to dispose of them. Any instruction to the depositary to continue holding the assets should be reported to the AIF's investors without undue delay. The AIFM or the AIF should give due consideration to the depositary's recommendations. Depending on the circumstances, if the depositary remains concerned that the standard of protection of the financial instrument is not sufficient, despite repeated warnings, it should consider further possible action, such as termination of the contract provided the AIF is given a period of time to find another depositary in accordance with national law.
- (120) To ensure the same standard of investor protection, the same considerations should also apply to the delegate to whom a depositary has contractually transferred its liability. Therefore, in order to be discharged of liability under Article 21(12) of Directive 2011/61/EU the delegate should prove that it fulfils cumulatively the same conditions.
- (121) A depositary is allowed under certain circumstances to discharge itself of liability for the loss of financial instruments held in custody by a third party to which custody was delegated. For such liability discharge to be permitted there must be an objective reason for contracting such discharge that is accepted by both the depositary and the AIF or the AIFM acting on behalf of the AIF. An objective reason should be established for each discharge of liability taking into account the concrete circumstances in which custody has been delegated.

- (122) When considering an objective reason, the right balance should be established to ensure that the contractual discharge can be effectively relied upon if needed and that sufficient safeguards are put in place to avoid any misuse of the contractual discharge of liability by the depositary. The contractual discharge of liability should under no circumstances be used to circumvent the depositary's liability requirements under Directive 2011/61/EU. The depositary should demonstrate that it was forced by the specific circumstances to delegate custody to a third party. Contracting a discharge should be always in the best interest of the AIF or its investors, and the AIF or the AIFM acting on behalf of the AIF should make it explicit that they act in such best interest. Examples of scenarios should indicate the situations where a depositary may be considered as not having other options but to delegate custody to third parties.
- (123) It is important for competent authorities to obtain appropriate and sufficient information in order to supervise activities of AIFMs and the risks related to them appropriately and consistently. Also, since the activities of AIFMs could have effects across borders and on the financial markets, competent authorities should monitor AIFMs and AIFs closely in order to take appropriate action to avoid the build-up of systemic risks. The increased transparency and consistency through provisions on reporting and disclosing relevant information as outlined in the implementing measures should make it possible for competent authorities to detect and respond to risks in the financial markets.
- (124) It is essential for investors to obtain the minimum information necessary with respect to particular AIFMs and AIFs and their structure in order to be able to take the right investment decision tailored to their needs and risk appetite. That information should be clear, reliable, readily understandable and clearly presented, whereas the usefulness of the information is enhanced when it is comparable from AIFM to AIFM and AIF to AIF and from one period to the next. An AIFM should not engage in activities which might be detrimental to the objective understanding and practical use of the information to investors prior to its disclosure such as window dressing.
- (125) It is necessary to set out a framework which provides for minimum standards with respect to annual reporting requirements, including key elements and a non-exhaustive list of items. Material changes in the information as referred to in Article 22(2) (d) of Directive 2011/61/EU should be disclosed in the annual report within the financial statements. In addition to the non-exhaustive list of underlying line items additional line items, headings and sub totals may be included where the presentation of these items is relevant for the understanding of an AIF's overall financial position or performance. Items of a dissimilar nature or function could be aggregated provided such items are individually not materially relevant. Those items could be aggregated under 'other category' such as 'other assets' or 'other liabilities'. Where line items do not apply to a particular AIF at all, they do not need to be presented. Regardless of the accounting standards followed in accordance with Directive 2011/61/EU, all assets should be valued at least once a year. The balance sheet or the statement of assets and liabilities under Directive 2011/61/EU should include, inter alia, cash and cash equivalents. Thus, cash equivalents should be considered highly liquid investments for the purpose of calculating the exposure of an AIF.
- (126) With respect to the content and format of the report on activities for the financial year which has to be part of the annual report under Directive 2011/61/EU, the report should include a fair and balanced review of the activities of the AIF with a

description of the principal risks and investments or economic uncertainties that it faces. That disclosure should not result in the publication of proprietary information of the AIF which would be to the detriment of the AIF and its investors. Therefore, if the publication of particular proprietary information would have such effect, it could be aggregated to a level that would avoid the detrimental effect and would not need to capture, for example, the performance or statistics of an individual portfolio company or investment that could lead to the disclosure of proprietary information of the AIF. This information should form part of the management report insofar as this is usually presented alongside the financial statements.

- (127) With respect to the content and format of the disclosure of remuneration where information is presented at the level of the AIFM, further information should be provided by disclosing an allocation or breakdown of the total remuneration as it relates to the relevant AIF. This could be achieved through disclosure of the total AIFM remuneration data split into fixed and variable components, a statement that these data relate to the entire AIFM, and not to the AIF, the number of AIFs and UCITS funds managed by the AIFM and the total assets under management of such AIFs and UCITS with an overview of the remuneration policy and a reference to where the full remuneration policy of the AIFM is available at the request of investors. Further details may be provided by disclosure of the total variable remuneration funded by the AIF through payment by it of performance fees or carried interest, as the case may be. In addition to the remuneration disclosure, it may be appropriate for AIFMs to provide information relating to the financial and non-financial criteria of the remuneration policies and practices for relevant categories of staff to enable investors to assess existing incentives created.
- (128) Where the AIF issues units, transfers of any assets to side pockets should be calculated, at the time of transfer, based on the number of units allocated on transfer of assets multiplied by the price per unit. The valuation basis should be clearly disclosed in all circumstances and include the date at which the valuation was performed.
- (129) In order to manage liquidity AIFMs should be permitted to enter into borrowing arrangements on behalf of AIFs they manage. Those arrangements can be short term or more permanent. In the latter case it is more likely that such an arrangement would be a special arrangement for the purpose of managing illiquid assets.
- (130) In line with the principle of differentiation, and recognising the diversity of types of AIFs, the disclosure to investors required of an AIFM should vary according to the type of AIF and would depend on other factors such as investment strategy and the portfolio composition.
- (131) Directive 2011/61/EU requires AIFMs to provide certain information on a regular basis to the competent authority of their home Member State for each EU AIFs they manage and for each of the AIF they market in the Union. It is therefore important to further specify the information to be provided and the frequency of the reporting which depend on the value of assets under management in portfolios of AIFs managed by a given AIFM. Pro-forma reporting templates should be provided for and should be completed by the AIFM for the AIFs it manages. Where an entity which is authorised as an AIFM markets AIFs which are managed by other AIFMs, it does not act as the manager of those AIFs but as an intermediary as any investment firm covered by Directive 2004/39/EC. It therefore should not have to report for these AIFs, as this

would lead to double- or multiple reporting. This reporting requirement should nevertheless apply to non-EU AIFMs that manage AIFs which are marketed in the Union.

- (132) The threshold provided in this Regulation triggers only reporting requirements laid down in Article 24(4) of Directive 2011/61/EU. An AIF with a leverage ratio calculated in accordance with the commitment method of less than three times its net asset value would not be considered as employing leverage on a substantial basis. However, competent authorities may request additional information where necessary for the effective monitoring of systemic risks. Setting a reporting threshold also ensures that information relating to the build-up of systemic risk is collected throughout the Union in a consistent way and provides certainty to AIFMs.
- (133) A competent authority's supervisory powers under Article 25(3) of Directive 2011/61/EU are exercised within the new supervisory system, forming part of what are on-going supervisory processes and systemic risk assessments of AIFMs by competent authorities and the European supervisory authorities, with reference to the stability and integrity of the financial system. Competent authorities should make appropriate use of the information they receive and should impose limits to leverage employed by an AIFM or other restrictions on the management of the AIF with respect to the AIFs managed where they deem this necessary in order to ensure the stability and integrity of the financial system. The assessment of systemic risk is likely to vary depending on the economic environment, whereby any AIFM, with respect to the AIFs it manages, has the potential to be systemically relevant. It is therefore a basic requirement that competent authorities obtain all the information necessary to assess those situations appropriately in order to avoid the build-up of systemic risk. Competent authorities should then assess the information thoroughly and take appropriate measures.
- (134) To allow EU AIFMs to manage and market non-EU AIFs and non-EU AIFMs to manage and market AIFs in the Union, Directive 2011/61/EU requires appropriate cooperation arrangements to be put in place with the relevant supervisory authorities of the third country where the non-EU AIF and, as the case may be, or the non-EU AIFM is established. Such cooperation arrangements should ensure at least an efficient exchange of information that allows Union competent authorities to carry out their duties in accordance with Directive 2011/61/EU.
- (135) Cooperation arrangements should allow competent authorities to carry out their supervisory and enforcement duties in respect of third country entities. Cooperation arrangements should therefore set out a clear concrete framework for access to information, for the carrying out of on-site inspections, and for assistance to be provided by the third country authorities. The cooperation arrangements should make sure that information received may be shared with other competent authorities concerned as well as with ESMA and the ESRB.
- (136) In order to allow competent authorities, AIFMs and depositaries to adapt to the new requirements contained in this Regulation so that they can be applied in an efficient and effective manner, the starting date of application of this Regulation should be aligned with the transposition date of Directive 2011/61/EU.

HAS ADOPTED THIS REGULATION:

## **Chapter I Definitions**

### *Article 1 Definitions*

In addition to the definitions laid down in Article 2 of Directive 2011/61/EU, the following definitions apply for the purposes of this Regulation

- (1) ‘capital commitment’ means the contractual commitment of an investor to provide the alternative investment fund (AIF) with an agreed amount of investment on request by the AIFM;
- (2) ‘relevant person’ in relation to an AIFM means any of the following:
  - (a) a director, partner or equivalent, or manager of the AIFM;
  - (b) an employee of the AIFM, or any other natural person whose services are placed at the disposal and under the control of the AIFM and who is involved in the provision of collective portfolio management services by the AIFM;
  - (c) a natural or legal person who is directly involved in the provision of services to the AIFM under a delegation arrangement to third parties for the purpose of the provision of collective portfolio management by the AIFM;
- (3) ‘senior management’ means the person or persons who effectively conduct the business of an AIFM in accordance with Article 8(1)(c) of Directive 2011/61/EU and, as the case may be, the executive member or members of the governing body;
- (4) ‘governing body’ means the body with ultimate decision making authority in an AIFM, comprising the supervisory and the managerial functions, or only the managerial function if the two functions are separated;
- (5) ‘special arrangement’ means an arrangement that arises as a direct consequence of the illiquid nature of the assets of an AIF which impacts the specific redemption rights of investors in a type of units or shares of the AIF and which is a bespoke or separate arrangement from the general redemption rights of investors.

## **Chapter II General provisions**

### **SECTION 1**

## CALCULATION OF ASSETS UNDER MANAGEMENT [ARTICLE 3(2) OF DIRECTIVE 2011/61/EU]

### *Article 2*

#### *Calculation of the total value of assets under management*

1. In order to qualify for the exemption provided for in Article 3(2) of Directive 2011/61/EU an AIFM shall:
  - (a) identify all AIFs for which it is appointed as the external AIFM or the AIF for which it is the AIFM, where the legal form of the AIF permits internal management, in accordance with Article 5 of Directive 2011/61/EU;
  - (b) identify for each managed AIF the portfolio of assets and determine in accordance with the valuation rules laid down in the law of the country where the AIF is established and, as the case may be, or in the AIF rules or instruments of incorporation the corresponding value of assets under management, including all assets acquired through use of leverage;
  - (c) aggregate the determined values of assets under management for all AIFs managed and compare the resulting total value of assets under management to the relevant threshold laid down in Article 3(2) of Directive 2011/61/EU.
2. For the purposes of paragraph 1, undertakings for collective investment in transferable securities (UCITS) for which the AIFM acts as the designated management company under Directive 2009/65/EC shall not be included in the calculation.

For the purposes of paragraph 1, AIFs managed by the AIFM for which the AIFM has delegated functions in accordance with Article 20 of Directive 2011/61/EU shall be included in the calculation. However, portfolios of AIFs that the AIFM is managing under delegation shall be excluded from the calculation.
3. For the purpose of calculating the total value of assets under management, each derivative instrument position, including any derivative embedded in transferable securities shall be converted into its equivalent position in the underlying assets of that derivative using the conversion methodologies set out in Article 10. The absolute value of that equivalent position shall then be used for the calculation of the total value of assets under management.
4. Where an AIF invests in other AIFs managed by the same externally appointed AIFM, that investment may be excluded from the calculation of the AIFM's assets under management.
5. Where one compartment within an internally or externally managed AIF invests in another compartment of that AIF, that investment may be excluded from the calculation of the AIFM's assets under management.
6. The total value of assets under management shall be calculated in accordance with paragraphs 1 to 4 at least annually and using the latest available asset values. The



latest available asset value for each AIF shall be produced during the twelve months preceding the date of the calculation of the threshold in accordance with the first sentence of this paragraph. The AIFM shall determine a threshold calculation date and apply it in a consistent manner. Any subsequent change to the date chosen must be justified to the competent authority. In selecting the threshold calculation date, the AIFM shall take into account the time and frequency of the valuation of the assets under management.

*Article 3*  
*On-going monitoring of assets under management*

AIFMs shall establish, implement and apply procedures to monitor on an on-going basis the total value of assets under management. Monitoring shall reflect an up-to-date overview of the assets under management and shall include the observation of subscription and redemption activity or, where applicable, capital draw downs, capital distributions and the value of the assets invested in for each AIF.

The proximity of the total value of assets under management to the threshold set in Article 3(2) of Directive 2011/61/EU and the anticipated subscription and redemption activity shall be taken into account in order to assess the need for more frequent calculations of the total value of assets under management.

*Article 4*  
*Occasional breach of the threshold*

1. The AIFM shall assess situations where the total value of assets under management exceeds the relevant threshold in order to determine whether or not they are of a temporary nature.
2. Where the total value of assets under management exceeds the relevant threshold and the AIFM considers that the situation is not of a temporary nature, the AIFM shall notify the competent authority without delay stating that the situation is considered not to be of a temporary nature and shall seek authorisation within 30 calendar days in accordance with Article 7 of Directive 2011/61/EU.
3. Where the total value of assets under management exceeds the relevant threshold and the AIFM considers that the situation is of a temporary nature, the AIFM shall notify the competent authority without delay, stating that the situation is considered to be of a temporary nature. The notification shall include supporting information to justify the AIFM's assessment of the temporary nature of the situation, including a description of the situation and an explanation of the reasons for considering it temporary.
4. A situation shall not be considered of a temporary nature if it is likely to continue for a period in excess of three months.
5. Three months after the date on which the total value of assets under management exceeds the relevant threshold the AIFM shall recalculate the total value of assets under management in order to demonstrate that it is below the relevant threshold or demonstrate to the competent authority that the situation which resulted in the assets

under management exceeding the threshold has been resolved and an application for authorisation of the AIFM is not required.

#### *Article 5*

##### *Information to be provided as part of registration*

1. As part of the requirement in Article 3(3)(b) of Directive 2011/61/EU, AIFMs shall communicate to the competent authorities the total value of assets under management calculated in accordance with the procedure set out in Article 2.
2. As part of the requirement in Article 3(3)(c) of Directive 2011/61/EU AIFMs shall provide for each AIF the offering document or a relevant extract from the offering document or a general description of the investment strategy. The relevant extract from the offering document and the description of the investment strategy shall include at least the following information:
  - (a) the main categories of assets in which the AIF may invest;
  - (b) any industrial, geographic or other market sectors or specific classes of assets which are the focus of the investment strategy;
  - (c) a description of the AIF's borrowing or leverage policy.
3. Information to be provided by the AIFM under point (d) of Article 3(3) of Directive 2011/61/EU is listed in Article 110(1) of this Regulation. It shall be provided in accordance with the pro-forma reporting template as set out in the Annex IV.
4. Information collected in accordance with Article 3(3)(d) of Directive 2011/61/EU shall be shared between competent authorities in the Union, with the European Securities and Markets Authority (ESMA) and the European Systemic Risk Board (ESRB) where necessary for the fulfilment of their duties.
5. The information required for registration purposes shall be updated and provided on an annual basis. For reasons relating to the exercise of their powers under Article 46 of Directive 2011/61/EU, the competent authorities may require an AIFM to provide the information referred to in Article 3 of Directive 2011/61/EU on a more frequent basis.

## **SECTION 2**

### **CALCULATION OF LEVERAGE [ARTICLE 4(3) OF DIRECTIVE 2011/61/EU]**

#### *Article 6*

##### *General provisions on the calculation of leverage*

1. Leverage of an AIF shall be expressed as the ratio between the exposure of an AIF and its net asset value.

2. AIFMs shall calculate the exposure of the AIFs managed in accordance with the gross method as set out in Article 7 and the commitment method as set out in Article 8.

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 sub-paragraph 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.

3. Exposure contained in any financial or legal structures involving third parties controlled by the relevant AIF shall be included in the calculation of the exposure where the structures referred to are specifically set up to directly or indirectly increase the exposure at the level of the AIF. For AIFs whose core investment policy is to acquire control of non-listed companies or issuers, the AIFM shall not include in the calculation of the leverage any exposure that exists at the level of those non-listed companies and issuers provided that the AIF or the AIFM acting on behalf of the AIF does not have to bear potential losses beyond its investment in the respective company or issuer.
4. AIFMs shall exclude borrowing arrangements entered into if these are temporary in nature and are fully covered by contractual capital commitments from investors in the AIF.
5. An AIFM shall have appropriately documented procedures to calculate the exposure of each AIF under its management in accordance with the gross method and the commitment method. The calculation shall be applied consistently over time.

#### *Article 7*

##### *Gross method for calculating the exposure of the AIF*

The exposure of an AIF calculated in accordance with the gross method shall be the sum of the absolute values of all positions valued in accordance with Article 19 of Directive 2011/61/EU and all delegated acts adopted pursuant to it.

For the calculation of the exposure of an AIF in accordance with the gross method an AIFM shall:

- (a) exclude the value of any cash and cash equivalents which are highly liquid investments held in the base currency of the AIF, that are readily convertible to a known amount of cash, are subject to an insignificant risk of change in value and provide a return no greater than the rate of a three-month high quality government bond;
- (b) convert derivative instruments into the equivalent position in their underlying assets using the conversion methodologies set out in Article 10 and the methods set out in paragraphs (4) to (9) and (14) of Annex I;
- (c) exclude cash borrowings that remain in cash or cash equivalent as referred to in point (a) and where the amounts of that payable are known;

- (d) include exposure resulting from the reinvestment of cash borrowings, expressed as the higher of the market value of the investment realised or the total amount of the cash borrowed as referred to in paragraphs (1) and (2) of Annex I;
- (e) include positions within repurchase or reverse repurchase agreements and securities lending or borrowing or other arrangements in accordance with paragraphs (3) and (10) to (13) of Annex I.

#### *Article 8*

##### *Commitment method for calculating the exposure of an AIF*

1. The exposure of an AIF calculated in accordance with the commitment method shall be the sum of the absolute values of all positions valued in accordance with Article 19 of Directive 2011/61/EU and its corresponding delegated acts, subject to the criteria provided for in paragraphs 2 to 9.
2. For the calculation of the exposure of an AIF in accordance with the commitment method an AIFM shall:
  - (a) convert each derivative instrument position into an equivalent position in the underlying asset of that derivative using the conversion methodologies set out in Article 10 and paragraphs (4) to (9) and (14) of Annex II;
  - (b) apply netting and hedging arrangements;
  - (c) calculate the exposure created through the reinvestment of borrowings where such reinvestment increases the exposure of the AIF as defined in paragraphs (1) and (2) of Annex I;
  - (d) include other arrangements in the calculation in accordance with paragraphs (3) and (10) to (13) of Annex I;
3. For the purposes of calculating the exposure of an AIF according to the commitment method:
  - (a) netting arrangements shall include combinations of trades on derivative instruments or security positions which refer to the same underlying asset, irrespective – in the case of derivative instruments – of the maturity date of the derivative instruments and where those trades on derivative instruments or security positions are concluded with the sole aim of eliminating the risks linked to positions taken through the other derivative instruments or security positions;
  - (b) hedging arrangements shall include combinations of trades on derivative instruments or security positions which do not necessarily refer to the same underlying asset and where those trades on derivative instruments or security positions are concluded with the sole aim of offsetting risks linked to positions taken through the other derivative instruments or security positions.

4. By way of derogation from paragraph 2, a derivative instrument shall not be converted into an equivalent position in the underlying asset if it has all of the following characteristics:
  - (a) it swaps the performance of financial assets held in the AIF's portfolio for the performance of other reference financial assets;
  - (b) it totally offsets the risks of the swapped assets held in the AIF's portfolio so that the AIF's performance does not depend on the performance of the swapped assets;
  - (c) it includes neither additional optional features, nor leverage clauses nor other additional risks as compared to a direct holding of the reference financial assets.
5. By way of derogation from paragraph 2, a derivative instrument shall not be converted into an equivalent position in the underlying asset when calculating the exposure according to the commitment method if it meets both of the following conditions:
  - (a) the combined holding by the AIF of a derivative instrument relating to a financial asset and cash which is invested in cash equivalent as defined in Article 7(a) is equivalent to holding a long position in the given financial asset;
  - (b) the derivative instrument shall not generate any incremental exposure and leverage or risk.
6. Hedging arrangements shall be taken into account when calculating the exposure of an AIF only if they comply with all the following conditions:
  - (a) the positions involved within the hedging relationship do not aim to generate a return and general and specific risks are offset;
  - (b) there is a verifiable reduction of market risk at the level of the AIF;
  - (c) the risks linked to derivative instruments, general and specific, if any, are offset;
  - (d) the hedging arrangements relate to the same asset class;
  - (e) they are efficient in stressed market conditions.
7. Subject to paragraph 6, derivative instruments used for currency hedging purposes and that do not add any incremental exposure, leverage or other risks shall not be included in the calculation.
8. An AIFM shall net positions in any of the following cases:
  - (a) between derivative instruments, provided they refer to the same underlying asset, even if the maturity date of the derivative instruments is different;
  - (b) between a derivative instrument whose underlying asset is a transferable security, money market instrument or units in a collective investment

undertaking as referred to in points 1 to 3 of Section C of Annex I of Directive 2004/39/EC, and that same corresponding underlying asset.

9. AIFMs managing AIFs that, in accordance with their core investment policy, primarily invest in interest rate derivatives shall make use of specific duration netting rules in order to take into account the correlation between the maturity segments of the interest rate curve as set out in Article 11.

#### *Article 9*

##### *Methods of increasing the exposure of an AIF*

When calculating exposure AIFMs shall use the methods set out in Annex I for the situations referred to therein.

#### *Article 10*

##### *Conversion methodologies for derivative instruments*

AIFMs shall use the conversion methodologies set out in Annex II for the derivative instruments referred to therein.

#### *Article 11*

##### *Duration netting rules*

1. Duration netting rules shall be applied by AIFMs when calculating the exposure of AIFs according to Article 8(9).
2. The duration-netting rules shall not be used where they would lead to a misrepresentation of the risk profile of the AIF. AIFMs availing themselves of those netting rules shall not include other sources of risk such as volatility in their interest rate strategy. Consequently, interest rate arbitrage strategies shall not apply those netting rules.
3. The use of those duration-netting rules shall not generate any unjustified level of leverage through investment in short-term positions. Short-dated interest rate derivatives shall not be the main source of performance for an AIF with medium duration which uses the duration netting rules.
4. Interest rate derivatives shall be converted into their equivalent underlying asset position and netted in accordance with Annex III.
5. An AIF making use of the duration-netting rules may still make use of the hedging framework. Duration netting rules may be applied only to the interest rate derivatives which are not included in hedging arrangements.

**SECTION 3**  
**ADDITIONAL OWN FUNDS AND PROFESSIONAL INDEMNITY INSURANCE**  
**[ARTICLES 9(7) AND ART.15 OF DIRECTIVE 2011/61/EU]**

*Article 12*  
*Professional liability risks*

1. The professional liability risks to be covered pursuant to Article 9(7) of Directive 2011/61/EU shall be risks of loss or damage caused by a relevant person through the negligent performance of activities for which the AIFM has legal responsibility.
2. Professional liability risks as defined in paragraph 1 shall include, without being limited to, risks of:
  - (a) loss of documents evidencing title of assets of the AIF;
  - (b) misrepresentations or misleading statements made to the AIF or its investors;
  - (c) acts, errors or omissions resulting in a breach of:
    - (i) legal and regulatory obligations;
    - (ii) duty of skill and care towards the AIF and its investors;
    - (iii) fiduciary duties;
    - (iv) obligations of confidentiality;
    - (v) AIF rules or instruments of incorporation;
    - (vi) terms of appointment of the AIFM by the AIF;
  - (d) failure to establish, implement and maintain appropriate procedures to prevent dishonest, fraudulent or malicious acts;
  - (e) improperly carried out valuation of assets or calculation of unit/share prices;
  - (f) losses arising from business disruption, system failures, failure of transaction processing or process management.
3. Professional liability risks shall be covered at all times either through appropriate additional own funds determined in accordance with Article 14 or through appropriate coverage of professional indemnity insurance determined in accordance with Article 15.

### *Article 13*

#### *Qualitative requirements addressing professional liability risks*

1. An AIFM shall implement effective internal operational risk management policies and procedures in order to identify, measure, manage and monitor appropriately operational risks including professional liability risks to which the AIFM is or could be reasonably exposed. The operational risk management activities shall be performed independently as part of the risk management policy.
2. An AIFM shall set up a historical loss database, in which any operational failures, loss and damage experience shall be recorded. This database shall record, without being limited to, any professional liability risks as referred to in Article 12(2) that have materialised.
3. Within the risk management framework the AIFM shall make use of its internal historical loss data and where appropriate of external data, scenario analysis and factors reflecting the business environment and internal control systems.
4. Operational risk exposures and loss experience shall be monitored on an on-going basis and shall be subject to regular internal reporting.
5. An AIFM's operational risk management policies and procedures shall be well documented. An AIFM shall have arrangements in place for ensuring compliance with its operational risk management policies and effective measures for the treatment of non-compliance with these policies. An AIFM shall have procedures in place for taking appropriate corrective action.
6. The operational risk management policies and procedures and measurement systems shall be subject to regular review, at least on an annual basis.
7. An AIFM shall maintain financial resources adequate to its assessed risk profile.

### *Article 14*

#### *Additional own funds*

1. This Article shall apply to AIFMs that choose to cover professional liability risks through additional own funds.
2. The AIFM shall provide additional own funds for covering liability risks arising from professional negligence at least equal to 0.01 % of the value of the portfolios of AIFs managed.

The value of the portfolios of AIFs managed shall be the sum of the absolute value of all assets of all AIFs managed by the AIFM, including assets acquired through use of leverage, whereby derivative instruments shall be valued at their market value.

3. The additional own funds requirement referred to in paragraph 2 shall be recalculated at the end of each financial year and the amount of additional own funds shall be adjusted accordingly.



The AIFM shall establish, implement and apply procedures to monitor on an on-going basis the value of the portfolios of AIFs managed, calculated in accordance with the second sub-paragraph of paragraph 2. Where, before the annual recalculation referred to in the first subparagraph, the value of the portfolios of AIFs managed increases significantly, the AIFM shall without undue delay recalculate the additional own funds requirement and shall adjust the additional own funds accordingly.

4. The competent authority of the home Member State of the AIFM may authorise the AIFM to provide additional own funds lower than the amount referred to in paragraph 2 only if it is satisfied — on the basis of the historical loss data of the AIFM as recorded over an observation period of at least three years prior to the assessment — that the AIFM provides sufficient additional own funds to appropriately cover professional liability risks. The authorised lower amount of additional own funds shall be not less than 0.008% of the value of the portfolios of AIFs managed by the AIFM.
5. The competent authority of the home Member State of the AIFM may request the AIFM to provide additional own funds higher than the amount referred to in paragraph 2 if it is not satisfied that the AIFM has sufficient additional own funds to appropriately cover professional liability risks. The competent authority shall give reasons why it considers that the AIFM's additional own funds are insufficient.

*Article 15*  
*Professional indemnity insurance*

1. This Article shall apply to AIFMs that choose to cover professional liability risks through professional indemnity insurance.
2. The AIFM shall take out and maintain at all times professional indemnity insurance that:
  - (a) shall have an initial term of no less than one year;
  - (b) shall have a notice period for cancellation of at least 90 days;
  - (c) shall cover professional liability risks as defined in Article 12(1) and (2);
  - (d) is taken out from an EU or non-EU undertaking authorised to provide professional indemnity insurance, in accordance with Union law or national law;
  - (e) is provided by a third party entity.

Any agreed defined excess shall be fully covered by own funds which are in addition to the own funds to be provided in accordance with Article 9(1) and (3) of Directive 2011/61/EU.

3. The coverage of the insurance for an individual claim shall be equal to at least 0.7 % of the value of the portfolios of AIFs managed by the AIFM calculated as set out in the second subparagraph of Article 14(2).

4. The coverage of the insurance for claims in aggregate per year shall be equal to at least 0.9 % of the value of the portfolios of AIFs managed by the AIFM calculated as set out in the second subparagraph of Article 14(2).
5. The AIFM shall review the professional indemnity insurance policy and its compliance with the requirements laid down in this Article at least once a year and in the event of any change which affects the policy's compliance with the requirements in this Article.

## **Chapter III**

### **Operating conditions for AIFMs**

#### **SECTION 1**

#### **GENERAL PRINCIPLES [ARTICLE 12(1) OF DIRECTIVE 2011/61/EU]**

##### *Article 16*

##### *General obligations for competent authorities*

When assessing the AIFM's compliance with Article 12(1) of Directive 2011/61/EU, the competent authorities shall use at least the criteria laid down in this Section.

##### *Article 17*

##### *Duty to act in the best interests of the AIF or the investors in the AIF and the integrity of the market*

1. AIFMs shall apply policies and procedures for preventing malpractices, including those that might reasonably be expected to affect adversely the stability and integrity of the market.
2. AIFMs shall ensure that the AIFs they manage or the investors in these AIFs are not charged undue costs.

##### *Article 18*

##### *Due diligence*

1. AIFMs shall apply a high standard of diligence in the selection and ongoing monitoring of investments.
2. AIFMs shall ensure that they have adequate knowledge and understanding of the assets in which the AIF is invested.
3. AIFMs shall establish, implement and apply written policies and procedures on due diligence and implement effective arrangements for ensuring that investment

decisions on behalf of the AIFs are carried out in compliance with the objectives, the investment strategy and, where applicable, the risk limits of the AIF.

4. The policies and procedures on due diligence referred to in paragraph 3 shall be regularly reviewed and updated.

#### *Article 19*

##### *Due diligence when investing in assets of limited liquidity*

1. Where AIFMs invest in assets of limited liquidity and where such investment is preceded by a negotiation phase, they shall, in relation to the negotiation phase, in addition to the requirements laid down in Article 18:
  - (a) set out and regularly update a business plan consistent with the duration of the AIF and market conditions;
  - (b) seek and select possible transactions consistent with the business plan referred to in point (a);
  - (c) assess the selected transactions in consideration of opportunities, if any, and overall related risks, all relevant legal, tax-related, financial or other value affecting factors, human and material resources, and strategies, including exit strategies;
  - (d) perform due diligence activities related to the transactions prior to arranging execution;
  - (e) monitor the performance of the AIF with respect to the business plan referred to in point (a).
2. AIFMs shall retain records of the activities carried out pursuant to paragraph 1 for at least five years.

#### *Article 20*

##### *Due diligence in the selection and appointment of counterparties and prime brokers*

1. When selecting and appointing counterparties and prime brokers, AIFMs shall exercise due skill, care and diligence before entering into an agreement and on an ongoing basis thereafter taking into account the full range and quality of their services.
2. When selecting prime brokers or counterparties of an AIFM or an AIF in an OTC derivatives transaction, in a securities lending or in a repurchase agreement, AIFMs shall ensure that those prime brokers and counterparties fulfil all of the following conditions:
  - (a) they are subject to ongoing supervision by a public authority;
  - (b) they are financially sound;

- (c) they have the necessary organisational structure and resources for performing the services which are to be provided by them to the AIFM or the AIF.
3. When appraising the financial soundness referred to in paragraph 2(b), the AIFM shall take into account whether or not the prime broker or counterparty is subject to prudential regulation, including sufficient capital requirements, and effective supervision.
  4. The list of selected prime brokers shall be approved by the AIFM's senior management. In exceptional cases prime brokers not included in the list may be appointed provided that they fulfil the requirements laid down in paragraph 2 and subject to approval by senior management. The AIFM shall be able to demonstrate the reasons for such a choice and the due diligence that it exercised in selecting and monitoring the prime brokers which had not been listed.

#### *Article 21*

##### *Acting honestly, fairly and with due skills*

In order to establish whether an AIFM conducts its activities honestly, fairly and with due skills, competent authorities shall assess, at least, whether the following conditions are met:

- (a) the governing body of the AIFM possesses adequate collective knowledge, skills and experience to be able to understand the AIFM's activities, in particular the main risks involved in those activities and the assets in which the AIF is invested;
- (b) the members of the governing body commit sufficient time to properly perform their functions in the AIFM;
- (c) each member of the governing body acts with honesty, integrity and independence of mind;
- (d) the AIFM devotes adequate resources to the induction and training of members of the governing body.

#### *Article 22*

##### *Resources*

1. AIFMs shall employ sufficient personnel with the skills, knowledge and expertise necessary for discharging the responsibilities allocated to them.
2. For the purposes of paragraph 1, AIFMs shall take into account the nature, scale and complexity of their business and the nature and range of services and activities undertaken in the course of that business.

#### *Article 23*

##### *Fair treatment of investors in the AIF*

1. The AIFM shall ensure that its decision-making procedures and its organisational structure, referred to in Article 57, ensure fair treatment of investors.

2. Any preferential treatment accorded by an AIFM to one or more investors shall not result in an overall material disadvantage to other investors.

*Article 24*  
*Inducements*

1. AIFMs shall not be regarded as acting honestly, fairly and in accordance with the best interests of the AIFs they manage or the investors in these AIFs if, in relation to the activities performed when carrying out the functions referred to in Annex I of Directive 2011/61/EU, they pay or are paid any fee or commission, or provide or are provided with any non-monetary benefit, other than the following:
  - (a) a fee, commission or non-monetary benefit paid or provided to or by the AIF or a person on behalf of the AIF;
  - (b) a fee, commission or non-monetary benefit paid or provided to or by a third party or a person acting on behalf of a third party, where the AIFM can demonstrate that the following conditions are satisfied:
    - (i) the existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating that amount, is clearly disclosed to the investors in the AIF in a manner that is comprehensive, accurate and understandable, prior to the provision of the relevant service;
    - (ii) the payment of the fee or commission, or the provision of the non-monetary benefit are designed to enhance the quality of the relevant service and not impair compliance with the AIFM's duty to act in the best interests of the AIF it manages or the investors in the AIF.
  - (c) proper fees which enable or are necessary for the provision of the relevant service, including custody costs, settlement and exchange fees, regulatory levies or legal fees, and which, by their nature, do not give rise to conflicts with the AIFM's duties to act honestly, fairly and in accordance with the best interests of the AIF it manages or the investors of the AIF.
2. The disclosure of the essential terms of the arrangements relating to the fee, commission or non-monetary benefit in summary form shall be considered as satisfactory for the purposes of point (i) of paragraph 1(b), provided that the AIFM commits to disclose further details at the request of the investor in the AIF it manages and provided that it fulfils this commitment.

*Article 25*  
*Effective employment of resources and procedures – handling of orders*

1. AIFMs shall establish, implement and apply procedures and arrangements which provide for the prompt, fair and expeditious execution of orders on behalf of the AIF.
2. The procedures and arrangements referred to in paragraph 1 shall satisfy the following requirements:

- (a) they shall ensure that orders executed on behalf of AIFs are promptly and accurately recorded and allocated;
  - (b) they shall execute otherwise comparable AIF orders sequentially and promptly unless the characteristics of the order or prevailing market conditions make this impracticable, or the interests of the AIF or of the investors in the AIF require otherwise.
3. The financial instruments, sums of money or other assets received in settlement of the executed orders shall be promptly and correctly delivered to or registered in the account of the relevant AIF.
4. AIFMs shall not misuse information related to pending AIF orders, and shall take all reasonable steps to prevent the misuse of such information by any of their relevant persons.

#### *Article 26*

##### *Reporting obligations in respect of execution of subscription and redemption orders*

1. Where AIFMs have carried out a subscription or, where relevant, a redemption order from an investor, they shall promptly provide the investor, by means of a durable medium, with the essential information concerning the execution of that order or the acceptance of the subscription offer, as the case may be.
2. Paragraph 1 shall not apply where a third person is required to provide the investor with a confirmation concerning the execution of the order and where the confirmation contains the essential information.

AIFMs shall ensure that the third person complies with its obligations.

3. The essential information referred to in paragraphs 1 and 2 shall include the following information:
  - (a) the identification of the AIFM;
  - (b) the identification of the investor;
  - (c) the date and time of receipt of the order;
  - (d) the date of execution;
  - (e) the identification of the AIF;
  - (f) the gross value of the order including charges for subscription or the net amount after charges for redemptions.
4. AIFMs shall supply the investor, upon request, with information about the status of the order or the acceptance of the subscription offer, or both as the case may be.

*Article 27*  
*Execution of decisions to deal on behalf of the managed AIF*

1. AIFMs shall act in the best interests of the AIFs or the investors in the AIFs they manage when executing decisions to deal on behalf of the managed AIF in the context of the management of their portfolio.
2. Whenever AIFMs buy or sell financial instruments or other assets for which best execution is relevant, and for the purposes of paragraph 1, they shall take all reasonable steps to obtain the best possible result for the AIFs they manage or the investors in these AIFs, taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. The relative importance of such factors shall be determined by reference to the following criteria:
  - (a) the objectives, investment policy and risks specific to the AIF, as indicated in the AIF's rules or articles of association, prospectus or offering documents of the AIF;
  - (b) the characteristics of the order;
  - (c) the characteristics of the financial instruments or other assets that are the subject of that order;
  - (d) the characteristics of the execution venues to which that order can be directed.
3. AIFMs shall establish and implement effective arrangements for complying with the obligations referred to in paragraphs 1 and 2. In particular, the AIFM shall establish in writing and implement an execution policy to allow AIFs and their investors to obtain, for AIF orders, the best possible result in accordance with paragraph 2.
4. AIFMs shall monitor on a regular basis the effectiveness of their arrangements and policy for the execution of orders with a view to identifying and, where appropriate, correcting any deficiencies.
5. AIFMs shall review their execution policy on an annual basis. A review shall also be carried out whenever a material change occurs that affects the AIFM's ability to continue to obtain the best possible result for the managed AIFs.
6. AIFMs shall be able to demonstrate that they have executed orders on behalf of the AIF in accordance with their execution policy.
7. Whenever there is no choice of different execution venues paragraphs 2 to 5 shall not apply. However, AIFMs shall be able to demonstrate that there is no choice of different execution venues.

## *Article 28*

### *Placing orders to deal on behalf of AIFs with other entities for execution*

1. Whenever the AIFM buys or sells financial instruments or other assets for which best execution is relevant, it shall act in the best interest of the AIFs it manages or the investors in the AIFs when placing orders to deal on behalf of the managed AIFs with other entities for execution, in the context of the management of their portfolio.
2. AIFMs shall take all reasonable steps to obtain the best possible result for the AIF or the investors in the AIF taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. The relative importance of such factors shall be determined by reference to the criteria laid down in Article 27(2).

AIFMs shall establish, implement and apply a policy to enable them to comply with the obligation referred to in the first subparagraph. The policy shall identify, in respect of each class of instruments, the entities with which the orders may be placed. The AIFM shall only enter into arrangements for execution where such arrangements are consistent with the obligations laid down in this Article. The AIFM shall make available to investors in the AIFs it manages appropriate information on the policy established in accordance with this paragraph and on any material changes to that policy.

3. AIFMs shall monitor on a regular basis the effectiveness of the policy established in accordance with paragraph 2 and, in particular, the quality of the execution by the entities identified in that policy and, where appropriate, correct any deficiencies.

In addition, AIFMs shall review the policy on an annual basis. Such a review shall also be carried out whenever a material change occurs that affects the AIFM's ability to continue to obtain the best possible result for the managed AIFs.

4. AIFMs shall be able to demonstrate that they have placed orders on behalf of the AIF in accordance with the policy established pursuant to paragraph 2.
5. Whenever there is no choice of different execution venues paragraphs 2 to 5 shall not apply. However, AIFMs shall be able to demonstrate that there is no choice of different execution venues.

## *Article 29*

### *Aggregation and allocation of trading orders*

1. AIFMs can only carry out an AIF order in aggregate with an order of another AIF, a UCITS or a client or with an order made when investing their own funds where:
  - (a) it can be reasonably expected that the aggregation of orders will not work overall to the disadvantage of any AIF, UCITS or clients whose order is to be aggregated;
  - (b) an order allocation policy is established and implemented, providing in sufficiently precise terms for the fair allocation of aggregated orders, including



how the volume and price of orders determines allocations and the treatment of partial executions.

2. Where an AIFM aggregates an AIF order with one or more orders of other AIFs, UCITS or clients and the aggregated order is partially executed, it shall allocate the related trades in accordance with its order allocation policy.
3. Where an AIFM aggregates transactions for its own account with one or more orders of AIFs, UCITS or clients, it shall not allocate the related trades in a way that is detrimental to the AIF, UCITS or a client.
4. Where an AIFM aggregates an order of an AIF, UCITS or another client with a transaction for its own account and the aggregated order is partially executed, it shall allocate the related trades to the AIF, UCITS or to clients in priority over those for own account.

However, if the AIFM is able to demonstrate to the AIF or to the client on reasonable grounds that it would not have been able to carry out the order on such advantageous terms without aggregation, or at all, it may allocate the transaction for its own account proportionally, in accordance with the policy referred to in point (b) of paragraph 1.

## **SECTION 2**

### **CONFLICTS OF INTEREST [ARTICLE 14 OF DIRECTIVE 2011/61/EU]**

#### *Article 30* *Types of conflicts of interest*

For the purpose of identifying the types of conflicts of interest that arise in the course of managing an AIF, AIFMs shall take into account, in particular, whether the AIFM, a relevant person or a person directly or indirectly linked by way of control to the AIFM:

- (a) is likely to make a financial gain, or avoid a financial loss, at the expense of the AIF or its investors;
- (b) has an interest in the outcome of a service or an activity provided to the AIF or its investors or to a client or of a transaction carried out on behalf of the AIF or a client, which is distinct from the AIF's interest in that outcome;
- (c) has a financial or other incentive to favour:
  - the interest of a UCITS, a client or group of clients or another AIF over the interest of the AIF;
  - the interest of one investor over the interest of another investor or group of investors in the same AIF;
- (d) carries out the same activities for the AIF and for another AIF, a UCITS or client; or

- (e) receives or will receive from a person other than the AIF or its investors an inducement in relation to collective portfolio management activities provided to the AIF, in the form of monies, goods or services other than the standard commission or fee for that service.

*Article 31*  
*Conflicts of interest policy*

1. The AIFM shall establish, implement and apply an effective conflicts of interest policy. That policy shall be set out in writing and shall be appropriate to the size and organisation of the AIFM and the nature, scale and complexity of its business.

Where the AIFM is a member of a group, the policy shall also take into account any circumstances of which the AIFM is or should be aware which may give rise to a conflict of interest resulting from the structure and business activities of other members of the group.

2. The conflicts of interest policy established in accordance with paragraph 1 shall include the following:
- (a) with reference to the activities carried out by or on behalf of the AIFM, including activities carried out by a delegate, sub-delegate, external valuer or counterparty, identification of the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of the AIF or its investors;
  - (b) procedures to be followed and measures to be adopted in order to prevent, manage and monitor such conflicts.

*Article 32*  
*Conflicts of interest related to the redemption of investments*

The AIFM that manages an open-ended AIF shall identify, manage and monitor conflicts of interest arising between investors wishing to redeem their investments and investors wishing to maintain their investments in the AIF, and any conflicts between the AIFM's incentive to invest in illiquid assets and the AIF's redemption policy in accordance with its obligations under Article 14(1) of Directive 2011/61/EU.

*Article 33*  
*Procedures and measures preventing or managing conflicts of interest*

1. The procedures and measures established for the prevention or management of conflicts of interest shall be designed to ensure that the relevant persons engaged in different business activities involving a risk of conflict of interest carry out these activities having a degree of independence which is appropriate to the size and activities of the AIFM and of the group to which it belongs, and to the materiality of the risk of damage to the interests of the AIF or its investors.

2. Where necessary and appropriate for the AIFM to ensure the requisite degree of independence, the procedures to be followed and measures to be adopted in accordance with point (b) of Article 31(2) shall include the following:
- (a) effective procedures to prevent or control the exchange of information between relevant persons engaged in collective portfolio management activities or other activities pursuant to Article 6(2) and (4) of Directive 2011/61/EU involving a risk of conflict of interest where the exchange of information may harm the interest of one or more AIFs or their investors;
  - (b) the separate supervision of relevant persons, whose principal functions involve carrying out collective portfolio management activities on behalf of, or providing services to, clients or investors, whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the AIFM;
  - (c) the removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;
  - (d) measures to prevent or restrain any person from exercising inappropriate influence over the way in which a relevant person carries out collective portfolio management activities;
  - (e) measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate collective portfolio management activities or other activities pursuant to Article 6(2) and (4) of Directive 2011/61/EU where such involvement may impair the proper management of conflicts of interest.

Where the adoption or the application of one or more of those measures and procedures does not ensure the requisite degree of independence, the AIFM shall adopt such alternative or additional measures and procedures as are necessary and appropriate for those purposes.

*Article 34*  
*Managing conflicts of interest*

Where the organisational or administrative arrangements made by the AIFM are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of the AIF or investors in the AIF are prevented, the senior management or other competent internal body of the AIFM shall be promptly informed in order to take any necessary decision or action to ensure that the AIFM acts in the best interests of the AIF or the investors in that AIF.

*Article 35*  
*Monitoring conflicts of interest*

1. The AIFM shall keep and regularly update a record of the types of activities undertaken by or on behalf of the AIFM in which a conflict of interest entailing a

material risk of damage to the interests of one or more AIFs or its investors has arisen or, in the case of an ongoing activity, may arise.

2. Senior management shall receive on a frequent basis, and at least annually, written reports on activities referred to in paragraph 1.

#### *Article 36*

##### *Disclosure of conflicts of interest*

1. The information to be disclosed to investors in accordance with Article 14(1) and (2) of Directive 2011/61/EU shall be provided to investors in a durable medium or by means of a website.
2. Where information referred to in paragraph 1 is provided by means of a website and is not addressed personally to the investor, the following conditions shall be satisfied:
  - (a) the investor has been notified of the address of the website, and the place on the website where the information may be accessed, and has consented to the provision of the information by such means;
  - (b) the information must be up to date;
  - (c) the information must be accessible continuously by means of that website for such period of time as the investor may reasonably need to inspect it.

#### *Article 37*

##### *Strategies for the exercise of voting rights*

1. An AIFM shall develop adequate and effective strategies for determining when and how any voting rights held in the AIF portfolios it manages are to be exercised, to the exclusive benefit of the AIF concerned and its investors.
2. The strategy referred to in paragraph 1 shall determine measures and procedures for:
  - (a) monitoring relevant corporate actions;
  - (b) ensuring that the exercise of voting rights is in accordance with the investment objectives and policy of the relevant AIF;
  - (c) preventing or managing any conflicts of interest arising from the exercise of voting rights.
3. A summary description of the strategies and details of the actions taken on the basis of those strategies shall be made available to the investors on their request.

### SECTION 3

## RISK MANAGEMENT [ARTICLE 15 OF DIRECTIVE 2011/61/EU]

#### *Article 38* *Risk management systems*

For the purposes of this Section, risk management systems shall be understood as systems comprised of relevant elements of the organisational structure of the AIFM, with a central role for a permanent risk management function, policies and procedures related to the management of risk relevant to each AIF's investment strategy, and arrangements, processes and techniques related to risk measurement and management employed by the AIFM in relation to each AIF it manages.

#### *Article 39* *Permanent risk management function*

1. An AIFM shall establish and maintain a permanent risk management function that shall:
  - (a) implement effective risk management policies and procedures in order to identify, measure, manage and monitor on an ongoing basis all risks relevant to each AIF's investment strategy to which each AIF is or may be exposed;
  - (b) ensure that the risk profile of the AIF disclosed to investors in accordance with point (c) of Article 23(4) of Directive 2011/61/EU is consistent with the risk limits that have been set in accordance with Article 44 of this Regulation;
  - (c) monitor compliance with the risk limits set in accordance with Article 44 and notify the AIFM's governing body and, where it exists, the AIFM's supervisory function in a timely manner when it considers the AIF's risk profile inconsistent with these limits or sees a material risk that the risk profile will become inconsistent with these limits;
  - (d) provide the following regular updates to the governing body of the AIFM and where it exists the AIFM's supervisory function at a frequency which is in accordance with the nature, scale and complexity of the AIF or the AIFM's activities:
    - (i) the consistency between and compliance with the risk limits set in accordance with Article 44 and the risk profile of the AIF as disclosed to investors in accordance with Article 23(4)(c) of Directive 2011/61/EU;
    - (ii) the adequacy and effectiveness of the risk management process, indicating in particular whether appropriate remedial measures have been or will be taken in the event of any actual or anticipated deficiencies;
  - (e) provide regular updates to the senior management outlining the current level of risk incurred by each managed AIF and any actual or foreseeable breaches of

any risk limits set in accordance with Article 44, so as to ensure that prompt and appropriate action can be taken.

2. The risk management function shall have the necessary authority and access to all relevant information necessary to fulfil the tasks set out in paragraph 1.

*Article 40*  
*Risk management policy*

1. An AIFM shall establish, implement and maintain an adequate and documented risk management policy which identifies all the relevant risks to which the AIFs it manages are or may be exposed.
2. The risk management policy shall comprise such procedures as are necessary to enable the AIFM to assess for each AIF it manages the exposure of that AIF to market, liquidity and counterparty risks, and the exposure of the AIF to all other relevant risks, including operational risks, which may be material for each AIF it manages.
3. The AIFM shall address at least the following elements in the risk management policy:
  - (a) the techniques, tools and arrangements that enable it to comply with Article 45;
  - (b) the techniques, tools and arrangements that enable liquidity risk of the AIF to be assessed and monitored under normal and exceptional liquidity conditions including through the use of regularly conducted stress tests in accordance with Article 48;
  - (c) the allocation of responsibilities within the AIFM pertaining to risk management;
  - (d) the limits set in accordance with Article 44 of this Regulation and a justification of how these are aligned with the risk profile of the AIF disclosed to investors in accordance with Article 23(4)(c) of Directive 2011/61/EU;
  - (e) the terms, contents, frequency and addressees of reporting by the permanent risk management function referred to in Article 39.
4. The risk management policy shall include a description of the safeguards referred to in Article 43, in particular:
  - (a) the nature of the potential conflicts of interest;
  - (b) the remedial measures put in place;
  - (c) the reasons why these measures should be reasonably expected to result in independent performance of the risk management function;
  - (d) how the AIFM expects to ensure that the safeguards are consistently effective.

5. The risk management policy referred to in paragraph 1 shall be appropriate to the nature, scale and complexity of the business of the AIFM and of the AIF it manages.

*Article 41*

*Assessment, monitoring and review of the risk management systems*

1. AIFMs shall assess, monitor and periodically, at least once a year, review:
  - (a) the adequacy and effectiveness of the risk management policy and of the arrangements, processes and techniques referred to in Article 45;
  - (b) the degree of compliance by the AIFM with the risk management policy and with the arrangements, processes and techniques referred to in Article 45;
  - (c) the adequacy and effectiveness of measures taken to address any deficiencies in the performance of the risk management process;
  - (d) the performance of the risk management function;
  - (e) the adequacy and effectiveness of measures aiming to ensure the functional and hierarchical separation of the risk management function in accordance with Article 42.

The frequency of the periodic review referred to in the first subparagraph shall be decided by the senior management in accordance with the principle of proportionality given the nature, scale and complexity of the AIFM's business and the AIF it manages.

2. In addition to the periodic review referred to in paragraph 1, the risk management systems shall be reviewed where:
  - (a) material changes are made to the risk management policies and procedures and to the arrangements, processes and techniques referred to in Article 45;
  - (b) internal or external events indicate that an additional review is required;
  - (c) material changes are made to the investment strategy and objectives of an AIF that the AIFM manages.
3. The AIFM shall update the risk management systems on the basis of the outcome of the review referred to in paragraphs 1 and 2.
4. The AIFM shall notify the competent authority of its home Member State of any material changes to the risk management policy and of the arrangements, processes and techniques referred to in Article 45.

#### *Article 42*

##### *Functional and hierarchical separation of the risk management function*

1. The risk management function shall be considered as functionally and hierarchically separated from the operating units, including the portfolio management function, only where all the following conditions are satisfied:
  - (a) persons engaged in the performance of the risk management function are not supervised by those responsible for the performance of the operating units, including the portfolio management function, of the AIFM;
  - (b) persons engaged in the performance of the risk management function are not engaged in the performance of activities within the operating units, including the portfolio management function;
  - (c) persons engaged in the performance of the risk management function are compensated in accordance with the achievement of the objectives linked to that function, independently of the performance of the operating units, including the portfolio management function;
  - (d) the remuneration of senior officers in the risk management function is directly overseen by the remuneration committee, where such a committee has been established.
2. The functional and hierarchical separation of the risk management function in accordance with paragraph 1 shall be ensured throughout the whole hierarchical structure of the AIFM, up to its governing body. It shall be reviewed by the governing body and, where it exists, the supervisory function of the AIFM.
3. The competent authorities of the home Member State of the AIFM shall review the way in which the AIFM has applied paragraphs 1 and 2 on the basis of the criteria laid down in the second sub-paragraph of Article 15(1) of Directive 2011/61/EU.

#### *Article 43*

##### *Safeguards against conflicts of interest*

1. The safeguards against conflicts of interest referred to in Article 15(1) of Directive 2011/61/EU shall ensure, at least, that:
  - (a) decisions taken by the risk management function are based on reliable data, which are subject to an appropriate degree of control by the risk management function;
  - (b) the remuneration of those engaged in the performance of the risk management function reflects the achievement of the objectives linked to the risk management function, independently of the performance of the business areas in which they are engaged;
  - (c) the risk management function is subject to an appropriate independent review to ensure that decisions are being arrived at independently;



- (d) the risk management function is represented in the governing body or the supervisory function, where it has been established, at least with the same authority as the portfolio management function;
  - (e) any conflicting duties are properly segregated.
2. Where proportionate, taking into account the nature, scale and complexity of the AIFM, the safeguards referred to in paragraph 1 shall also ensure that:
- (a) the performance of the risk management function is reviewed regularly by the internal audit function, or, if the latter has not been established, by an external party appointed by the governing body;
  - (b) where a risk committee has been established, it is appropriately resourced and its non-independent members do not have undue influence over the performance of the risk management function.
3. The governing body of the AIFM and, where it exists, the supervisory function shall establish the safeguards against conflicts of interest laid down in paragraphs 1 and 2, regularly review their effectiveness and take timely remedial action to address any deficiencies.

*Article 44*  
*Risk limits*

1. An AIFM shall establish and implement quantitative or qualitative risk limits, or both, for each AIF it manages, taking into account all relevant risks. Where only qualitative limits are set, the AIFM shall be able to justify this approach to the competent authority.
2. The qualitative and quantitative risk limits for each AIF shall, at least, cover the following risks:
- (a) market risks;
  - (b) credit risks;
  - (c) liquidity risks;
  - (d) counterparty risks;
  - (e) operational risks.
3. When setting risk limits, the AIFM shall take into account the strategies and assets employed in respect of each AIF it manages as well as the national rules applicable to each of those AIFs. Those risk limits shall be aligned with the risk profile of the AIF as disclosed to investors in accordance with point (c) of Article 23(4) of Directive 2011/61/EU and approved by the governing body.

*Article 45*  
*Risk measurement and management*

1. AIFMs shall adopt adequate and effective arrangements, processes and techniques in order to:
  - (a) identify, measure, manage and monitor at any time the risks to which the AIFs under their management are or might be exposed;
  - (b) ensure compliance with the limits set in accordance with Article 44.
2. The arrangements, processes and techniques referred to in paragraph 1 shall be proportionate to the nature, scale and complexity of the business of the AIFM and of each AIF it manages and shall be consistent with the AIF's risk profile as disclosed to investors in accordance with point (c) of Article 23(4) of Directive 2011/61/EU.
3. For the purposes of paragraph 1, the AIFM shall take the following actions for each AIF it manages:
  - (a) put in place such risk measurement arrangements, processes and techniques as are necessary to ensure that the risks of positions taken and their contribution to the overall risk profile are accurately measured on the basis of sound and reliable data and that the risk measurement arrangements, processes and techniques are adequately documented;
  - (b) conduct periodic back-tests in order to review the validity of risk measurement arrangements which include model-based forecasts and estimates;
  - (c) conduct, periodic appropriate stress tests and scenario analyses to address risks arising from potential changes in market conditions that might adversely impact the AIF;
  - (d) ensure that the current level of risk complies with the risk limits set in accordance with Article 44;
  - (e) establish, implement and maintain adequate procedures that, in the event of actual or anticipated breaches of the risk limits of the AIF, result in timely remedial actions in the best interest of investors;
  - (f) ensure that there are appropriate liquidity management systems and procedures for each AIF in line with the requirements laid down in Article 46.

**SECTION 4**  
**LIQUIDITY MANAGEMENT [ARTICLE 16 OF DIRECTIVE 2011/61/EU]**

*Article 46*  
*Liquidity management system and procedures*

AIFMs shall be able to demonstrate to the competent authorities of their home Member State that an appropriate liquidity management system and effective procedures referred to in Article 16(1) of Directive 2011/61/EU are in place taking into account the investment strategy, the liquidity profile and the redemption policy of each AIF.

*Article 47*  
*Monitoring and managing liquidity risk*

1. The liquidity management system and procedures referred to in Article 46 shall at least, ensure that:
  - (a) the AIFM maintains a level of liquidity in the AIF appropriate to its underlying obligations, based on an assessment of the relative liquidity of the AIF's assets in the market, taking account of the time required for liquidation and the price or value at which those assets can be liquidated, and their sensitivity to other market risks or factors;
  - (b) the AIFM monitors the liquidity profile of the AIF's portfolio of assets, having regard to the marginal contribution of individual assets which may have a material impact on liquidity, and the material liabilities and commitments, contingent or otherwise, which the AIF may have in relation to its underlying obligations. For these purposes the AIFM shall take into account the profile of the investor base of the AIF, including the type of investors, the relative size of investments and the redemption terms to which these investments are subject;
  - (c) the AIFM, where the AIF invests in other collective investment undertakings, monitors the approach adopted by the managers of those other collective investment undertakings to the management of liquidity, including through conducting periodic reviews to monitor changes to the redemption provisions of the underlying collective investment undertakings in which the AIF invests. Subject to Article 16(1) of Directive 2011/61/EU, this obligation shall not apply where the other collective investment undertakings in which the AIF invests are actively traded on a regulated market within the meaning of point (14) of Article 4(1) of Directive 2004/39/EC or an equivalent third country market;
  - (d) the AIFM implements and maintains appropriate liquidity measurement arrangements and procedures to assess the quantitative and qualitative risks of positions and of intended investments which have a material impact on the liquidity profile of the portfolio of the AIF's assets to enable their effects on the overall liquidity profile to be appropriately measured. The procedures

employed shall ensure that the AIFM has the appropriate knowledge and understanding of the liquidity of the assets in which the AIF has invested or intends to invest including, where applicable, the trading volume and sensitivity of prices and, as the case may be, or spreads of individual assets in normal and exceptional liquidity conditions;

- (e) the AIFM considers and puts into effect the tools and arrangements, including special arrangements, necessary to manage the liquidity risk of each AIF under its management. The AIFM shall identify the types of circumstances where these tools and arrangements may be used in both normal and exceptional circumstances, taking into account the fair treatment of all AIF investors in relation to each AIF under management. The AIFM may use such tools and arrangements only in these circumstances and if appropriate disclosures have been made in accordance with Article 108.
2. AIFMs shall document their liquidity management policies and procedures, as referred to in paragraph 1, review them on at least an annual basis and update them for any changes or new arrangements.
  3. AIFMs shall include appropriate escalation measures in their liquidity management system and procedures, as referred to in paragraph 1, to address anticipated or actual liquidity shortages or other distressed situations of the AIF.
  4. Where the AIFM manages an AIF which is a leveraged closed-ended AIF, point(e) of paragraph 1 shall not apply.

#### *Article 48*

##### *Liquidity management limits and stress tests*

1. AIFMs shall, where appropriate, considering the nature, scale and complexity of each AIF they manage, implement and maintain adequate limits for the liquidity or illiquidity of the AIF consistent with its underlying obligations and redemption policy and in accordance with the requirements laid down in Article 44 relating to quantitative and qualitative risk limits.

AIFMs shall monitor compliance with those limits and where limits are exceeded or likely to be exceeded, they shall determine the required (or necessary) course of action. In determining appropriate action, AIFMs shall consider the adequacy of the liquidity management policies and procedures, the appropriateness of the liquidity profile of the AIF's assets and the effect of atypical levels of redemption requests.

2. AIFMs shall regularly conduct stress tests, under normal and exceptional liquidity conditions, which enable them to assess the liquidity risk of each AIF under their management. The stress tests shall:
  - (a) be conducted on the basis of reliable and up-to-date information in quantitative terms or, where this is not appropriate, in qualitative terms;
  - (b) where appropriate, simulate a shortage of liquidity of the assets in the AIF and atypical redemption requests;

- (c) cover market risks and any resulting impact, including on margin calls, collateral requirements or credit lines;
  - (d) account for valuation sensitivities under stressed conditions;
  - (e) be conducted at a frequency which is appropriate to the nature of the AIF, taking in to account the investment strategy, liquidity profile, type of investor and redemption policy of the AIF, and at least once a year.
3. AIFMs shall act in the best interest of investors in relation to the outcome of any stress tests.

#### *Article 49*

#### *Alignment of investment strategy, liquidity profile and redemption policy*

1. For the purposes of Article 16(2) of Directive 2011/61/EU, the investment strategy, liquidity profile and redemption policy of each AIF managed by an AIFM shall be considered to be aligned when investors have the ability to redeem their investments in a manner consistent with the fair treatment of all AIF investors and in accordance with the AIF's redemption policy and its obligations.
2. In assessing the alignment of the investment strategy, liquidity profile and redemption policy the AIFM shall also have regard to the impact that redemptions may have on the underlying prices or spreads of the individual assets of the AIF.

### **SECTION 5**

### **INVESTMENT IN SECURITISATION POSITIONS [ARTICLE 17 OF DIRECTIVE 2011/61/EU]**

#### *Article 50*

#### *Definitions*

For the purposes of this section

- (a) 'securitisation' means a securitisation within the meaning of Article 4(36) of Directive 2006/48/EC;
- (b) 'securitisation position' means a securitisation position within the meaning of Article 4(40) of Directive 2006/48/EC;
- (c) 'sponsor' means a sponsor within the meaning of Article 4(42) of Directive 2006/48/EC;
- (d) 'tranche' means a tranche within the meaning of Article 4(39) of Directive 2006/48/EC

*Article 51*  
*Requirements for retained interest*

1. AIFMs shall assume exposure to the credit risk of a securitisation on behalf of one or more AIFs it manages only if the originator, sponsor or original lender has explicitly disclosed to the AIFM that it retains, on an ongoing basis, a material net economic interest, which in any event shall not be less than 5 %.

Only any of the following shall qualify as retention of a material net economic interest of not less than 5%:

- (a) retention of no less than 5 % of the nominal value of each of the tranches sold or transferred to the investors;
- (b) in the case of securitisations of revolving exposures, retention of the originator's interest of no less than 5% of the nominal value of the securitised exposures;
- (c) retention of randomly selected exposures, equivalent to not less than 5% of the nominal value of the securitised exposures, where such exposures would otherwise have been securitised in the securitisation, provided that the number of potentially securitised exposures is not less than 100 at origination;
- (d) retention of the first loss tranche and, if necessary, other tranches having the same or a more severe risk profile than those transferred or sold to investors and not maturing any earlier than those transferred or sold to investors, so that the retention equals in total not less than 5% of the nominal value of the securitised exposures;
- (e) retention of a first loss exposure of not less than 5% of every securitised exposure in the securitisation.

Net economic interest shall be measured at the origination and shall be maintained on an ongoing basis. The net economic interest, including retained positions, interest or exposures, shall not be subject to any credit risk mitigation or any short positions or any other hedge and shall not be sold. The net economic interest shall be determined by the notional value for off-balance sheet items.

There shall be no multiple applications of the retention requirements for any given securitisation.

2. Paragraph 1 shall not apply where the securitised exposures are claims or contingent claims on or fully, unconditionally and irrevocably guaranteed by the institutions listed in the first subparagraph of Article 122a (3) of Directive 2006/48/EC, and shall not apply to those transactions listed in the second subparagraph of Article 122a (3) of Directive 2006/48/EC.

## *Article 52*

### *Qualitative requirements concerning sponsors and originators*

Prior to an AIFM assuming exposure to the credit risk of a securitisation on behalf of one or more AIFs, it shall ensure that the sponsor and originator:

- (a) grant credit based on sound and well-defined criteria and clearly establish the process for approving, amending, renewing and re-financing loans to exposures to be securitised as they apply to exposures they hold;
- (b) have in place and operate effective systems to manage the ongoing administration and monitoring of their credit risk-bearing portfolios and exposures, including for identifying and managing problem loans and for making adequate value adjustments and provisions;
- (c) adequately diversify each credit portfolio based on the target market and overall credit strategy;
- (d) have a written policy on credit risk that includes their risk tolerance limits and provisioning policy and describes how it measures, monitors and controls that risk;
- (e) grant readily available access to all materially relevant data on the credit quality and performance of the individual underlying exposures, cash flows and collateral supporting a securitisation exposure and such information that is necessary to conduct comprehensive and well informed stress tests on the cash flows and collateral values supporting the underlying exposures. For that purpose, materially relevant data shall be determined as at the date of the securitisation and where appropriate due to the nature of the securitisation thereafter;
- (f) grant readily available access to all other relevant data necessary for the AIFM to comply with the requirements laid down in Article 53;
- (g) disclose the level of their retained net economic interest as referred to in Article 51, as well as any matters that could undermine the maintenance of the minimum required net economic interest as referred to in that Article.

## *Article 53*

### *Qualitative requirements concerning AIFMs exposed to securitisations*

1. Before becoming exposed to the credit risk of a securitisation on behalf of one or more AIFs, and as appropriate thereafter, AIFMs shall be able to demonstrate to the competent authorities for each of their individual securitisation positions that they have a comprehensive and thorough understanding of those positions and have implemented formal policies and procedures appropriate to the risk profile of the relevant AIF's investments in securitised positions for analysing and recording:
  - (a) information disclosed under Article 51, by originators or sponsors to specify the net economic interest that they maintain, on an ongoing basis, in the securitisation;
  - (b) the risk characteristics of the individual securitisation position;

- (c) the risk characteristics of the exposures underlying the securitisation position;
- (d) the reputation and loss experience in earlier securitisations of the originators or sponsors in the relevant exposure classes underlying the securitisation position;
- (e) the statements and disclosures made by the originators or sponsors, or their agents or advisors, about their due diligence on the securitised exposures and, where applicable, on the quality of the collateral supporting the securitised exposures;
- (f) where applicable, the methodologies and concepts on which the valuation of collateral supporting the securitised exposures is based and the policies adopted by the originator or sponsor to ensure the independence of the valuer;
- (g) all the structural features of the securitisation that can materially impact the performance of the institution's securitisation position, such as the contractual waterfall and waterfall related triggers, credit enhancements, liquidity enhancements, market value triggers, and deal-specific definitions of default.

2. Where an AIFM has assumed exposure to a material value of the credit risk of a securitisation on behalf of one or more AIFs, it shall regularly perform stress tests appropriate to such securitisation positions in accordance with point (b) of Article 15(3) of Directive 2011/61/EU. The stress test shall be commensurate with the nature, scale and complexity of the risk inherent in the securitisation positions.

AIFMs shall establish formal monitoring procedures in line with the principles laid down in Article 15 of Directive 2011/61/EU commensurate with the risk profile of the relevant AIF in relation to the credit risk of a securitisation position in order to monitor on an ongoing basis and in a timely manner performance information on the exposures underlying such securitisation positions. Such information shall include (if relevant to the specific type of securitisation and not limited to such types of information further described herein), the exposure type, the percentage of loans more than 30, 60 and 90 days past due, default rates, prepayment rates, loans in foreclosure, collateral type and occupancy, frequency distribution of credit scores or other measures of credit worthiness across underlying exposures, industry and geographical diversification and frequency distribution of loan to value ratios with bandwidths that facilitate adequate sensitivity analysis. Where the underlying exposures are themselves securitisation positions, AIFMs shall have the information set out in this subparagraph not only on the underlying securitisation tranches, such as the issuer name and credit quality, but also on the characteristics and performance of the pools underlying those securitisation tranches.

AIFMs shall apply the same standards of analysis to participations or underwritings in securitisation issues purchased from third parties.

3. For the purposes of appropriate risk and liquidity management, AIFMs assuming exposure to the credit risk of a securitisation on behalf of one or more AIFs shall properly identify, measure, monitor, manage, control and report the risks that arise because of mismatches between the assets and liabilities of the relevant AIF, concentration risk or investment risk arising from these instruments. The AIFM shall ensure that the risk profile of such securitisation positions corresponds to the size, overall portfolio structure, investment strategies and objectives of the relevant AIF as



laid down in the AIF rules or instruments of incorporation, prospectus and offering documents.

4. AIFMs shall ensure, in line with the requirements laid down in Article 18 of Directive 2011/61/EU, that there is an adequate degree of internal reporting to the senior management so that senior management is fully aware of any material assumption of exposure to securitisations and that the risks arising from those exposures are adequately managed.
5. AIFMs shall include appropriate information on their exposures to the credit risk of securitisation and their risk management procedures in this area in the reports and disclosures to be submitted in accordance with Articles 22, 23 and 24 of Directive 2011/61/EU.

*Article 54*  
*Corrective action*

1. AIFMs shall take such corrective action as is in the best interest of the investors in the relevant AIF where they discover, after the assumption of an exposure to a securitisation, that the determination and disclosure of the retained interest did not meet the requirements laid down in this Regulation.
2. AIFMs shall take such corrective action as is in the best interest of the investors in the relevant AIF, where the retained interest becomes less than 5% at a given moment after the assumption of the exposure and this is not due to the natural payment mechanism of the transaction.

*Article 55*  
*Grandfathering clause*

Articles 51 to 54 shall apply in relation to new securitisations issued on or after 1 January 2011. Articles 51 to 54 shall, after 31 December 2014, apply in relation to existing securitisations where new underlying exposures are added or substituted after that date.

*Article 56*  
*Interpretation*

In the absence of specific interpretation given by ESMA or by the Joint Committee of the European Supervisory Authorities, the provisions of this Section shall be interpreted in a consistent manner with the corresponding provisions of Directive 2006/48/EC and with the Guidelines to Article 122a of the Capital Requirements Directive of 31 December 2010<sup>14</sup> issued by the Committee of European Banking Supervisors and their subsequent amendments.

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<sup>14</sup> Committee of European Banking Supervisors, Guidelines to Article 122a of the Capital Requirements Directive of 31 December 2010, <http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Application%20of%20Art.%20122a%20of%20the%20CRD/Guidelines.pdf>.

**SECTION 6**  
**ORGANISATIONAL REQUIREMENTS – GENERAL PRINCIPLES [ARTICLES 12 AND 18 OF DIRECTIVE 2011/61/EU]**

*Article 57*  
*General requirements*

1. AIFMs shall:
  - (a) establish, implement and maintain decision-making procedures and an organisational structure which specifies reporting lines and allocates functions and responsibilities clearly and in a documented manner;
  - (b) ensure that their relevant persons are aware of the procedures to be followed for the proper discharge of their responsibilities;
  - (c) establish, implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the AIFM;
  - (d) establish, implement and maintain effective internal reporting and communication of information at all relevant levels of the AIFM and effective information flows with any third party involved;
  - (e) maintain adequate and orderly records of their business and internal organisation.

AIFMs shall take into account the nature, scale and complexity of their business and the nature and range of services and activities undertaken in the course of that business.

2. AIFMs shall establish, implement and maintain systems and procedures that are adequate to safeguard the security, integrity and confidentiality of information, taking into account the nature of the information in question.
3. AIFMs shall establish, implement and maintain an adequate business continuity policy aimed at ensuring, in the event of an interruption to their systems and procedures, the preservation of essential data and functions, and the maintenance of services and activities, or, where that is not possible, the timely recovery of such data and functions and the timely resumption of their services and activities.
4. AIFMs shall establish, implement and maintain accounting policies and procedures and valuation rules that enable them, at the request of the competent authority, to deliver in a timely manner to the competent authority financial reports which reflect a true and fair view of their financial position and which comply with all applicable accounting standards and rules.

5. AIFMs shall implement appropriate policies and procedures to ensure that the redemption policies of the AIF are disclosed to investors, in sufficient detail, before they invest in the AIF and in the event of material changes.
6. AIFMs shall monitor and, on a regular basis, evaluate the adequacy and effectiveness of their systems, internal control mechanisms and arrangements established in accordance with paragraphs 1 to 5, and take appropriate measures to address any deficiencies.

#### *Article 58*

##### *Electronic data processing*

1. AIFMs shall make appropriate and sufficient arrangements for suitable electronic systems so as to permit the timely and proper recording of each portfolio transaction or subscription or, where relevant, redemption order.
2. AIFMs shall ensure a high standard of security during the electronic data processing and integrity and confidentiality of the recorded information, as appropriate.

#### *Article 59*

##### *Accounting procedures*

1. AIFMs shall employ accounting policies and procedures as referred to in Article 57(4) so as to ensure the protection of investors. The accounting records shall be kept in such a way that all assets and liabilities of the AIF can be directly identified at all times. If an AIF has different investment compartments, separate accounts shall be maintained for those compartments.
2. AIFMs shall establish, implement and maintain accounting and valuation policies and procedures so as to ensure that the net asset value of each AIF is accurately calculated on the basis of the applicable accounting rules and standards.

#### *Article 60*

##### *Control by the governing body, senior management and supervisory function*

1. When allocating functions internally, AIFMs shall ensure that the governing body, the senior management and, where it exists, the supervisory function are responsible for the AIFM's compliance with its obligations under Directive 2011/61/EU.
2. An AIFM shall ensure that its senior management:
  - (a) is responsible for the implementation of the general investment policy for each managed AIF, as defined, where relevant, in the fund rules, the instruments of incorporation, the prospectus or the offering documents;
  - (b) oversees the approval of the investment strategies for each managed AIF;
  - (c) is responsible for ensuring that valuation policies and procedures in accordance with Article 19 of Directive 2011/61/EU are established and implemented;

- (d) is responsible for ensuring that the AIFM has a permanent and effective compliance function, even if this function is performed by a third party;
  - (e) ensures and verifies on a periodic basis that the general investment policy, the investment strategies and the risk limits of each managed AIF are properly and effectively implemented and complied with, even if the risk management function is performed by third parties;
  - (f) approves and reviews on a periodic basis the adequacy of the internal procedures for undertaking investment decisions for each managed AIF, so as to ensure that such decisions are consistent with the approved investment strategies;
  - (g) approves and reviews on a periodic basis the risk management policy and the arrangements, processes and techniques for implementing that policy, including the risk limit system for each AIF it manages;
  - (h) is responsible for establishing and applying a remuneration policy in line with Annex II of Directive 2011/61/EU.
3. An AIFM shall also ensure that its senior management and, where appropriate, its governing body or supervisory function :
- (a) assess and periodically review the effectiveness of the policies, arrangements and procedures put in place to comply with the obligations laid down in Directive 2011/61/EU;
  - (b) take appropriate measures to address any deficiencies.
4. An AIFM shall ensure that its senior management receives on a frequent basis, and at least annually, written reports on matters of compliance, internal audit and risk management indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies.
5. An AIFM shall ensure that its senior management receives on a regular basis reports on the implementation of investment strategies and of the internal procedures for taking investment decisions referred to in points (b) to (e) of paragraph 2.
6. An AIFM shall ensure that the governing body or the supervisory function, if any, receives on a regular basis written reports on the matters referred to in paragraph 4.

*Article 61*  
*Permanent compliance function*

1. AIFMs shall establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the AIFM to comply with its obligations under Directive 2011/61/EU, and the associated risks, and put in place adequate measures and procedures designed to minimise such risk and to enable the competent authorities to exercise their powers effectively under that Directive.

The AIFM shall take into account the nature, scale and complexity of its business, and the nature and range of services and activities undertaken in the course of that business.

2. An AIFM shall establish and maintain a permanent and effective compliance function which operates independently and has the following responsibilities:
  - (a) monitoring and, on a regular basis, evaluating the adequacy and effectiveness of the measures, policies and procedures put in place in accordance with paragraph 1 and the actions taken to address any deficiencies in the AIFM's compliance with its obligations;
  - (b) advising the relevant persons responsible for carrying out services and activities and assisting them in complying with the AIFM's obligations under Directive 2011/61/EU.
3. In order to enable the compliance function referred to in paragraph 2 to perform its responsibilities properly and independently, the AIFM shall ensure that:
  - (a) the compliance function has the necessary authority, resources, expertise and access to all relevant information;
  - (b) a compliance officer is appointed and is responsible for the compliance function and for reporting on a frequent basis, and at least annually, to the senior management on matters of compliance, indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies;
  - (c) persons in the compliance function are not involved in the performance of services or activities they monitor;
  - (d) the method of determining the remuneration of a compliance officer and other persons in the compliance function do not affect their objectivity and are not likely to do so.

However, the AIFM shall not be required to comply with points (c) or (d) of the first subparagraph where it is able to demonstrate that in view of the nature, scale and complexity of its business, and the nature and range of its services and activities, that the requirement is not proportionate and that its compliance function continues to be effective.

*Article 62*  
*Permanent internal audit function*

1. AIFMs shall, where appropriate and proportionate in view of the nature, scale and complexity of their business and the nature and range of collective portfolio management activities undertaken in the course of that business, establish and maintain an internal audit function which is separate and independent from the other functions and activities of the AIFM.
2. The internal audit function referred to in paragraph 1 shall:

- (a) establish, implement and maintain an audit plan to examine and evaluate the adequacy and effectiveness of the AIFM's systems, internal control mechanisms and arrangements;
- (b) issue recommendations based on the results of work carried out in accordance with point (a);
- (c) verify compliance with the recommendations referred to in point (b);
- (d) report internal audit matters.

*Article 63*  
*Personal transactions*

1. For any relevant person who is involved in activities that may give rise to a conflict of interest, or who has access to inside information within the meaning of Article 1(1) of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse)<sup>15</sup> or to other confidential information relating to an AIF or transactions with or for an AIF, an AIFM shall establish, implement and maintain adequate arrangements aimed at preventing such relevant persons from:
  - (a) entering into a personal transaction in financial instruments or other assets which fulfils one of the following criteria:
    - (i) the transaction is subject to Article 2(1) of Directive 2003/6/EC;
    - (ii) the transaction involves the misuse or improper disclosure of confidential information;
    - (iii) the transaction conflicts or is likely to conflict with an obligation of the AIFM under Directive 2011/61/EU;
  - (b) advising or inducing, other than in the proper course of his employment or contract for services, any other person to enter into a personal transaction referred to in point (a)(i) and (ii) , or that would otherwise constitute a misuse of information relating to pending orders;
  - (c) disclosing, other than in the normal course of his employment or contract for services and without prejudice to Article 3(a) of Directive 2003/6/EC, any information or opinion to any other person if the relevant person knows, or reasonably ought to know, that as a result of that disclosure that other person would or would be likely to take either of the following steps:
    - (i) entering into a personal transaction referred to in point (a)(i) and (ii) in financial instruments or other assets or that would otherwise constitute a misuse of information relating to pending orders;

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<sup>15</sup> OJ L96, 12.4.2003, p.16.

- (ii) advising or inducing another person to enter into such a personal transaction.
- 2. The arrangements referred to in paragraph 1 shall in particular be designed to ensure that:
  - (a) each relevant person is aware of the restrictions on personal transactions referred to in paragraph 1, and of the measures established by the AIFM in connection with personal transactions and disclosure, pursuant to paragraph 1;
  - (b) the AIFM is informed promptly of any personal transaction entered into by a relevant person covered by paragraph 1, either by notification of that transaction or by other procedures enabling the AIFM to identify such transactions;
  - (c) a record is kept of the personal transaction notified to the AIFM or identified by it, including any authorisation or prohibition in connection with such a transaction.

For the purposes of point (b) of the first subparagraph, where certain activities of the AIFM are performed by third parties, the AIFM shall ensure that the entity performing the activity maintains a record of personal transactions entered into by any relevant person covered by paragraph 1 and provides that information to the AIFM promptly on request.

- 3. Paragraphs 1 and 2 shall not apply to personal transactions:
  - (a) effected under a discretionary portfolio management service where there is no prior communication in connection with the transaction between the portfolio manager and the relevant person or other person for whose account the transaction is executed;
  - (b) in UCITS or AIFs that are subject to supervision under the law of a Member State which requires an equivalent level of risk spreading in their assets, where the relevant person and any other person for whose account the transactions are effected are not involved in the management of that undertaking.
- 4. For the purpose of paragraph 1, a personal transaction shall also include a transaction in a financial instrument or other asset effected on behalf or for the account of :
  - (a) a relevant person;
  - (b) any person with whom the relevant person has a family relationship or with whom the relevant person has close links;
  - (c) a person whose relationship with the relevant person is such that the relevant person has a direct or indirect material interest in the outcome of the trade, other than a fee or commission for the execution of the trade.

*Article 64*  
*Recording of portfolio transactions*

1. AIFMs shall make without delay for each portfolio transaction relating to AIFs it manages a record of information which is sufficient to reconstruct the details of the order and the executed transaction or of the agreement.
2. With regard to portfolio transactions on an execution venue, the record referred to in paragraph 1 shall include the following information:
  - (a) the name or other designation of the AIF and of the person acting for the account of the AIF;
  - (b) the asset;
  - (c) where relevant, the quantity;
  - (d) the type of the order or transaction;
  - (e) the price;
  - (f) for orders, the date and exact time of the transmission of the order and the name or other designation of the person to whom the order was transmitted, or for transactions, the date and exact time of the decision to deal and the execution of the transaction;
  - (g) where applicable, the name of the person transmitting the order or executing the transaction;
  - (h) where applicable, the reasons for the revocation of an order;
  - (i) for executed transactions the counterparty and execution venue identification.
3. With regard to portfolio transactions by the AIF outside an execution venue, the record referred to in paragraph 1 shall include the following information:
  - (a) the name or other designation of the AIF;
  - (b) the legal and other documentation that forms the basis of the portfolio transaction, including in particular the agreement as executed;
  - (c) the price.
4. For the purposes of paragraphs 2 and 3, an execution venue shall include a systematic internaliser as referred to in point (7) of Article 4(1) of Directive 2004/39/EC, a regulated market as referred to in point (14) of Article 4(1) of that Directive, a multilateral trading facility as referred to in point (15) of Article 4(1) of that Directive, a market maker as referred to in point (8) of Article 4(1) of that Directive or other liquidity provider or an entity that performs a similar function in a third country to the functions performed by any of the foregoing.



*Article 65*  
*Recording of subscription and redemption orders*

1. AIFMs shall take all reasonable steps to ensure that received AIF subscriptions and, where relevant, redemption orders are recorded without undue delay after receipt of any such order.
2. That record shall include information on the following:
  - (a) the relevant AIF;
  - (b) the person giving or transmitting the order;
  - (c) the person receiving the order;
  - (d) the date and time of the order;
  - (e) the terms and means of payment;
  - (f) the type of the order;
  - (g) the date of execution of the order;
  - (h) the number of units or shares or equivalent amounts subscribed or redeemed;
  - (i) the subscription or, where relevant, redemption price for each unit or share or, where relevant, the amount of capital committed and paid;
  - (j) the total subscription or redemption value of the units or shares;
  - (k) the gross value of the order including charges for subscription, or the net amount after charges for redemption.

Information under points (i), (j) and (k) shall be recorded as soon as available.

*Article 66*  
*Recordkeeping requirements*

1. AIFMs shall ensure that all required records referred to in Articles 64 and 65 are retained for a period of at least five years.

However, competent authorities may require AIFMs to ensure that any or all of those records are retained for a longer period, taking into account the nature of the asset or portfolio transaction, where it is necessary to enable the authority to exercise its supervisory functions under Directive 2011/61/EU.

2. Following the termination of the authorisation of an AIFM, the records are to be retained at least for the outstanding term of the five years period referred to in paragraph 1. Competent authorities may require retention for a longer period.

Where the AIFM transfers its responsibilities in relation to the AIF to another AIFM, it shall ensure that the records referred to in paragraph 1 are accessible to that AIFM.

3. The records shall be retained on a medium that allows the storage of information in a way accessible for future reference by the competent authorities, and in such a form and manner that:
  - (a) the competent authorities are able to access them readily and to reconstitute each key stage of the processing of each portfolio transaction;
  - (b) corrections or other amendments, and the contents of the records prior to such corrections or amendments, may be easily ascertained;
  - (c) no other manipulation or alteration is possible.

## **SECTION 7**

### **VALUATION [ARTICLE 19 OF DIRECTIVE 2011/61/EU]**

#### *Article 67*

#### *Policies and procedures for the valuation of the assets of the AIF*

1. AIFMs shall establish, maintain, implement and review, for each AIF they manage, written policies and procedures that ensure a sound, transparent, comprehensive and appropriately documented valuation process. The valuation policy and procedures shall cover all material aspects of the valuation process and valuation procedures and controls in respect of the relevant AIF.

Without prejudice to requirements under national law and the AIF rules and instruments of incorporation, the AIFM shall ensure that fair, appropriate and transparent valuation methodologies are applied for the AIFs it manages. The valuation policies shall identify and the procedures shall implement the valuation methodologies used for each type of asset in which the AIF may invest in accordance with applicable national law, the AIF rules and the instruments of incorporation. The AIFM shall not invest in a particular type of asset for the first time unless an appropriate valuation methodology or methodologies have been identified for that specific type of asset.

The policies and procedures setting out valuation methodologies shall include inputs, models and the selection criteria for pricing and market data sources. They shall provide that prices shall be obtained from independent sources whenever possible and appropriate. The selection process of a particular methodology shall include an assessment of the available relevant methodologies, taking into account their sensitivity to changes in variables and how specific strategies determine the relative value of the assets in the portfolio.

2. The valuation policies shall set out the obligations, roles and responsibilities of all parties involved in the valuation process, including the senior management of the AIFM. The procedures shall reflect the organisational structure as set out in the valuation policies.

The valuation policies and procedures shall address at least the following:

- (a) the competence and independence of personnel who are effectively carrying out the valuation of assets;
  - (b) the specific investment strategies of the AIF and the assets the AIF might invest in;
  - (c) the controls over the selection of valuation inputs, sources and methodologies;
  - (d) the escalation channels for resolving differences in values for assets;
  - (e) the valuation of any adjustments related to the size and liquidity of positions, or to changes in the market conditions, as appropriate;
  - (f) the appropriate time for closing the books for valuation purposes;
  - (g) the appropriate frequency for valuing assets.
3. Where an external valuer is appointed, the valuation policies and procedures shall set out a process for the exchange of information between the AIFM and the external valuer to ensure that all necessary information required for the purpose of performing the valuation task is provided.

The valuation policies and procedures shall ensure that the AIFM conducts initial and periodic due diligence on third parties that are appointed to perform valuation services.

4. Where the valuation is performed by the AIFM itself, the policies shall include a description of the safeguards for the functionally independent performance of the valuation task in accordance with point (b) of Article 19(4) of Directive 2011/61/EU. Such safeguards shall include measures to prevent or restrain any person from exercising inappropriate influence over the way in which a person carries out valuation activities.

#### *Article 68* *Use of models to value assets*

1. If a model is used to value the assets of an AIF, the model and its main features shall be explained and justified in the valuation policies and procedures. The reason for the choice of the model, the underlying data, the assumptions used in the model and the rationale for using them, and the limitations of the model-based valuation shall be appropriately documented.
2. The valuation policies and procedures shall ensure that before being used a model is validated by a person with sufficient expertise who has not been involved in the process of building that model. The validation process shall be appropriately documented.
3. The model shall be subject to prior approval by the senior management of the AIFM. Where the model is used by an AIFM that performs the valuation function itself, the approval by the senior management shall be without prejudice to the competent

authority's right to require under Article 19(9) of Directive 2011/61/EU that the model be verified by an external valuer or an auditor.

#### *Article 69*

##### *Consistent application of valuation policies and procedures*

1. An AIFM shall ensure that the valuation policies and procedures and the designated valuation methodologies are applied consistently.
2. The valuation policies and procedures and the designated methodologies shall be applied to all assets within an AIF taking into account the investment strategy, the type of asset and, if applicable, the existence of different external valuers.
3. Where no update is required, the policies and procedures shall be applied consistently over time and valuation sources and rules shall remain consistent over time.
4. The valuation procedures and the designated valuation methodologies shall be applied consistently across all AIFs managed by the same AIFM, taking into account the investment strategies and the types of asset held by the AIFs, and, if applicable, the existence of different external valuers.

#### *Article 70*

##### *Periodic review of valuation policies and procedures*

1. Valuation policies shall provide for a periodic review of the policies and procedures, including of the valuation methodologies. The review shall be carried out at least annually and before the AIF engages with a new investment strategy or a new type of asset that is not covered by the actual valuation policy.
2. The valuation policies and procedures shall outline how a change to the valuation policy, including a methodology, may be effected and in what circumstances this would be appropriate. Recommendations for changes to the policies and procedures shall be made to the senior management, which shall review and approve any changes.
3. The risk management function referred to in Article 38 shall review and, if needed, provide appropriate support concerning the policies and procedures adopted for the valuation of assets.

#### *Article 71*

##### *Review of individual values of assets*

1. An AIFM shall ensure that all assets held by the AIF are fairly and appropriately valued. The AIFM shall document by type of asset the way the appropriateness and fairness of the individual values is assessed. The AIFM shall at all times be able to demonstrate that the portfolios of AIFs it manages are properly valued.

2. The valuation policies and procedures shall set out a review process for the individual values of assets, where a material risk of an inappropriate valuation exists, such as in the following cases:
  - (a) the valuation is based on prices only available from a single counterparty or broker source;
  - (b) the valuation is based on illiquid exchange prices;
  - (c) the valuation is influenced by parties related to the AIFM;
  - (d) the valuation is influenced by other entities that may have a financial interest in the AIF's performance;
  - (e) the valuation is based on prices supplied by the counterparty who originated an instrument, in particular where the originator is also financing the AIF's position in the instrument;
  - (f) the valuation is influenced by one or more individuals within the AIFM.
3. The valuation policies and procedures shall describe the review process including sufficient and appropriate checks and controls on the reasonableness of individual values. Reasonableness shall be assessed in terms of the existence of an appropriate degree of objectivity. Such checks and controls shall include at least:
  - (a) verifying values by a comparison amongst counterparty-sourced pricings and over time;
  - (b) validating values by comparison of realised prices with recent carrying values;
  - (c) considering the reputation, consistency and quality of the valuation source;
  - (d) a comparison with values generated by a third party;
  - (e) an examination and documentation of exemptions;
  - (f) highlighting and researching any differences that appear unusual or vary by valuation benchmark established for the type of asset;
  - (g) testing for stale prices and implied parameters;
  - (h) a comparison with the prices of any related assets or their hedges;
  - (i) a review of the inputs used in model-based pricing, in particular of those to which the model's price exhibits significant sensitivity.
4. The valuation policies and procedures shall include appropriate escalation measures to address differences or other problems in the valuation of assets.

*Article 72*  
*Calculation of the net asset value per unit or share*

1. An AIFM shall ensure that for each AIF it manages the net asset value per unit or share is calculated on the occasion of each issue or subscription or redemption or cancellation of units or shares, but at least once a year.
2. An AIFM shall ensure that the procedures and the methodology for calculating the net asset value per unit or share are fully documented. The calculation procedures and methodologies and their application shall be subject to regular verification by the AIFM, and the documentation shall be amended accordingly.
3. An AIFM shall ensure that remedial procedures are in place in the event of an incorrect calculation of the net asset value.
4. An AIFM shall ensure that the number of units or shares in issue is subject to regular verification, at least as often as the unit or share price is calculated.

*Article 73*  
*Professional guarantees*

1. External valuers shall provide upon request professional guarantees to demonstrate their ability to perform the valuation function. Professional guarantees to be furnished by external valuers shall be in written form.
2. The professional guarantees shall contain evidence of the external valuer's qualification and capability to perform proper and independent valuation, including, at least, evidence of:
  - (a) sufficient personnel and technical resources;
  - (b) adequate procedures safeguarding proper and independent valuation;
  - (c) adequate knowledge and understanding of the investment strategy of the AIF and of the assets the external valuer is appointed to value;
  - (d) a sufficiently good reputation and sufficient experience with valuation.
3. Where the external valuer is subject to mandatory professional registration with the competent authority or another entity of the state where it is established, the professional guarantee shall contain the name of this authority or entity, including the relevant contact information. The professional guarantee shall indicate clearly the legal or regulatory provisions or rules of professional conduct to which the external valuer is subject.

*Article 74*  
*Frequency of valuation of assets held by open-ended AIFs*

1. The valuation of financial instruments held by open-ended AIFs shall take place every time the net asset value per unit or share is calculated pursuant to Article 72(1).

2. The valuation of other assets held by open-ended AIFs shall take place at least once a year, and every time there is evidence that the last determined value is no longer fair or proper.

**SECTION 8**  
**DELEGATION OF AIFM FUNCTIONS [ARTICLE 20(1), (2), (4) AND (5) OF**  
**DIRECTIVE 2011/61/EU]**

*Article 75*  
*General principles*

When delegating the task of carrying out one or more functions on their behalf, AIFMs shall comply, in particular, with the following general principles:

- (a) the delegation structure does not allow for the circumvention of the AIFM's responsibilities or liability;
- (b) the obligations of the AIFM towards the AIF and its investors are not altered as a result of the delegation;
- (c) the conditions with which the AIFM must comply in order to be authorised and carry out activities in accordance with Directive 2011/61/EU are not undermined;
- (d) the delegation arrangement takes the form of a written agreement concluded between the AIFM and the delegate;
- (e) the AIFM ensures that the delegate carries out the delegated functions effectively and in compliance with applicable law and regulatory requirements and must establish methods and procedures for reviewing on an on-going basis the services provided by the delegate. The AIFM shall take appropriate action if it appears that the delegate cannot carry out the functions effectively or in compliance with applicable laws and regulatory requirements;
- (f) the AIFM supervises effectively the delegated functions and manages the risks associated with the delegation. For this purpose the AIFM shall have at all times the necessary expertise and resources to supervise the delegated functions. The AIFM shall set out in the agreement its right of information, inspection, admittance and access, and its instruction and monitoring rights against the delegate. The AIFM shall also ensure that the delegate properly supervises the performance of the delegated functions, and adequately manages the risks associated with the delegation;
- (g) the AIFM ensures that the continuity and quality of the delegated functions or of the delegated task of carrying out functions are maintained also in the event of termination of the delegation either by transferring the delegated functions or the delegated task of carrying out functions to another third party or by performing them itself;
- (h) the respective rights and obligations of the AIFM and the delegate are clearly allocated and set out in the agreement. In particular, the AIFM shall contractually

ensure its instruction and termination rights, its rights of information, and its right to inspections and access to books and premises. The agreement shall make sure that sub-delegation can take place only with the consent of the AIFM;

- (i) where it concerns portfolio management, the delegation is in accordance with the investment policy of the AIF. The delegate shall be instructed by the AIFM how to implement the investment policy and the AIFM shall monitor whether the delegate complies with it on an on-going basis;
- (j) the AIFM ensures that the delegate discloses to the AIFM any development that may have a material impact on the delegate's ability to carry out the delegated functions effectively and in compliance with applicable laws and regulatory requirements;
- (k) the AIFM ensures that the delegate protects any confidential information relating to the AIFM, the AIF affected by the delegation and the investors in that AIF;
- (l) the AIFM ensures that the delegate establishes, implements and maintains a contingency plan for disaster recovery and periodic testing of backup facilities while taking into account the types of delegated functions.

#### *Article 76*

##### *Objective reasons for delegation*

1. The AIFM shall provide the competent authorities with a detailed description, explanation and evidence of the objective reasons for delegation. When assessing whether the entire delegation structure is based on objective reasons within the meaning of Article 20(1) (a) of Directive 2011/61/EU the following criteria shall be considered:
  - (a) optimising of business functions and processes;
  - (b) cost saving;
  - (c) expertise of the delegate in administration or in specific markets or investments;
  - (d) access of the delegate to global trading capabilities.
2. Upon request by the competent authorities, an AIFM shall provide further explanations and provide documents proving that the entire delegation structure is based on objective reasons.

#### *Article 77*

##### *Features of the delegate*

1. A delegate shall have sufficient resources and shall employ sufficient personnel with the skills, knowledge and expertise necessary for the proper discharge of the tasks delegated to it and have an appropriate organizational structure supporting the performance of the delegated tasks



2. Persons who effectively conduct the activities delegated by the AIFM shall have sufficient experience, appropriate theoretical knowledge and appropriate practical experience in the relevant functions. Their professional training and the nature of the functions they have performed in the past shall be appropriate for the conduct of the business.
3. Persons who effectively conduct the business of the delegate shall not be deemed of sufficiently good repute if they have any negative records relevant both for the assessment of good repute and for the proper performance of the delegated tasks or if there is other relevant information which affects their good reputation. Such negative records shall include but shall not be limited to criminal offences, judicial proceedings or administrative sanctions relevant for the performance of the delegated tasks. Special attention shall be given to any offences related to financial activities, including but not limited to obligations relating to the prevention of money laundering, dishonesty, fraud or financial crime, bankruptcy or insolvency. Other relevant information shall include information such as that indicating that the person is not trustworthy or honest.

Where the delegate is regulated in respect of its professional services within the Union, factors referred to in the first subparagraph shall be deemed to be satisfied when the relevant supervisory authority has reviewed the criterion of ‘good repute’ within the authorization procedure unless there is evidence to the contrary.

#### *Article 78*

##### *Delegation of portfolio or risk management*

1. This Article shall apply where the delegation of portfolio management or risk management is concerned.
2. The following entities shall be deemed to be authorised or registered for the purpose of asset management and subject to supervision in accordance with point (c) of Article 20(1) of Directive 2011/61/EU :
  - (a) management companies authorised under Directive 2009/65/EC;
  - (b) investment firms authorized under Directive 2004/39/EC to perform portfolio management;
  - (c) credit institutions authorised under Directive 2006/48/EC having the authorisation to perform portfolio management under Directive 2004/39/EC;
  - (d) external AIFMs authorised under Directive 2011/61/EU;
  - (e) third country entities authorised or registered for the purpose of asset management and effectively supervised by a competent authority in those countries.
3. Where the delegation is conferred on a third-country undertaking the following conditions shall be fulfilled in accordance with point (d) of Article 20(1) of Directive 2011/61/EU:

- (a) a written arrangement shall exist between the competent authorities of the home Member State of the AIFM and the supervisory authorities of the undertaking to which delegation is conferred;
- (b) with respect to the undertaking to which delegation is conferred, the arrangement referred to in point (a) allows the competent authorities to:
  - (i) obtain on request the relevant information necessary to carry out their supervisory tasks as provided for in Directive 2011/61/EU;
  - (ii) obtain access to the documents relevant for the performance of their supervisory duties maintained in the third country;
  - (iii) carry out on-site inspections on the premises of the undertaking to which functions were delegated. The practical procedures for on-site inspections shall be detailed in the written arrangement;
  - (iv) receive as soon as possible information from the supervisory authority in the third country for the purpose of investigating apparent breaches of the requirements of Directive 2011/61/EU and its implementing measures;
  - (v) cooperate in enforcement in accordance with the national and international law applicable to the supervisory authority of the third country and the EU competent authorities in cases of breach of the requirements of Directive 2011/61/EU and its implementing measures and relevant national law.

*Article 79*  
*Effective supervision*

A delegation shall be deemed to prevent the effective supervision of the AIFM where:

- (a) the AIFM, its auditors and the competent authorities do not have effective access to data related to the delegated functions and to the business premises of the delegate, or the competent authorities are not able to exercise those rights of access;
- (b) the delegate does not cooperate with the competent authorities of the AIFM in connection with the delegated functions;
- (c) the AIFM does not make available on request to the competent authorities all information necessary to enable authorities to supervise the compliance of the performance of the delegated functions with the requirements of Directive 2011/61/EU and its implementing measures.

*Article 80*  
*Conflicts of interest*

1. In accordance with point (b) of Article 20(2) of Directive 2011/61/EU, the criteria to assess whether a delegation conflicts with the interests of the AIFM or the investor in the AIF shall at least include:

- (a) where the AIFM and the delegate are members of the same group or have any other contractual relationship, the extent to which the delegate controls the AIFM or has the ability to influence its actions;
  - (b) where the delegate and an investor in the relevant AIF are members of the same group or have any other contractual relationship, the extent to which this investor controls the delegate or has the ability to influence its actions;
  - (c) the likelihood that the delegate makes a financial gain, or avoids a financial loss, at the expense of the AIF or the investors in the AIF;
  - (d) the likelihood that the delegate has an interest in the outcome of a service or an activity provided to the AIFM or the AIF;
  - (e) the likelihood that the delegate has a financial or other incentive to favour the interest of another client over the interests of the AIF or the investors in the AIF;
  - (f) the likelihood that the delegate receives or will receive from a person other than the AIFM an inducement in relation to the collective portfolio management activities provided to the AIFM and the AIFs it manages in the form of monies, goods or services other than the standard commission or fee for that service.
2. The portfolio or risk management function may be considered to be functionally and hierarchically separated from other potentially conflicting tasks only where the following conditions are satisfied:
- (a) persons engaged in portfolio management tasks are not engaged in the performance of potentially conflicting tasks such as controlling tasks;
  - (b) persons engaged in risk management tasks are not engaged in the performance of potentially conflicting tasks such as operating tasks;
  - (c) persons engaged in risk management functions are not supervised by those responsible for the performance of operating tasks;
  - (d) the separation is ensured throughout the whole hierarchical structure of the delegate up to its governing body and is reviewed by the governing body and, where it exists, the supervisory function of the delegate.
3. Potential conflicts of interest shall be deemed properly identified, managed, monitored and disclosed to the investors of the AIF only if:
- (a) the AIFM ensures that the delegate takes all reasonable steps to identify, manage and monitor potential conflicts of interest that may arise between itself and the AIFM, the AIF or the investors in the AIF. The AIFM shall ensure that the delegate has procedures in place corresponding to those required under Articles 31 to 34.
  - (b) the AIFM ensures that the delegate discloses potential conflicts of interest as well as the procedures and measures to be adopted by it in order to manage

such conflicts of interest to the AIFM which shall disclose them to the AIF and the investors in the AIF in accordance with Article 36.

#### *Article 81*

##### *Consent and notification of sub-delegation*

1. A subdelegation shall become effective where the AIFM demonstrates its consent to it in writing.

A general consent given in advance by the AIFM shall not be deemed consent in accordance with point (a) of Article 20(4) of Directive 2011/61/EU.

2. Pursuant to point (b) of Article 20(4) of Directive 2011/61/EU, the notification shall contain details of the delegate, the name of the competent authority where the sub-delegate is authorised or registered, the delegated functions, the AIFs affected by the sub-delegation, a copy of the written consent by the AIFM and the intended effective date of the sub-delegation.

#### *Article 82*

##### *Letter-box entity and AIFM no longer considered to be managing an AIF*

1. An AIFM shall be deemed a letter-box entity and shall no longer be considered to be the manager of the AIF at least in any of the following situations:
  - (a) the AIFM no longer retains the necessary expertise and resources to supervise the delegated tasks effectively and manage the risks associated with the delegation;
  - (b) the AIFM no longer has the power to take decisions in key areas which fall under the responsibility of the senior management or no longer has the power to perform senior management functions in particular in relation to the implementation of the general investment policy and investment strategies;
  - (c) the AIFM loses its contractual rights to inquire, inspect, have access or give instructions to its delegates or the exercise of such rights becomes impossible in practice;
  - (d) the AIFM delegates the performance of investment management functions to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself. When assessing the extent of delegation, competent authorities shall assess the entire delegation structure taking into account not only the assets managed under delegation but also the following qualitative criteria:
    - (i) the types of assets the AIF or the AIFM acting on behalf of the AIF is invested in, and the importance of the assets managed under delegation for the risk and return profile of the AIF;
    - (ii) the importance of the assets under delegation for the achievement of the investment goals of the AIF;
    - (iii) the geographical and sectoral spread of the AIF's investments,

- (iv) the risk profile of the AIF;
  - (v) the type of investment strategies pursued by the AIF or the AIFM acting on behalf of the AIF;
  - (vi) the types of tasks delegated in relation to those retained; and
  - (vii) the configuration of delegates and their sub-delegates, their geographical sphere of operation and their corporate structure, including whether the delegation is conferred on an entity belonging to the same corporate group as the AIFM.
2. The Commission shall monitor, in the light of market developments, the application of this Article. The Commission shall review the situation after two years and shall, if necessary, take appropriate measures to further specify the conditions under which the AIFM shall be deemed to have delegated its functions to the extent that it becomes a letter box entity and can no longer be considered to be manager of the AIF.
  3. ESMA may issue guidelines to ensure a consistent assessment of delegation structures across the Union.

## **Chapter IV Depositary**

### **SECTION 1**

#### **PARTICULARS OF THE WRITTEN CONTRACT [ARTICLE 21(2) OF DIRECTIVE 2011/61/EU]**

##### *Article 83*

##### *Contractual particulars*

1. A contract by which the depositary is appointed in accordance with Article 21(2) of Directive 2011/61/EU shall be drawn up between the depositary on the one hand and the AIFM and, as the case may be, or the AIF on the other hand and shall include at least the following elements:
  - (a) a description of the services to be provided by the depositary and the procedures to be adopted for each type of asset in which the AIF may invest and which shall then be entrusted to the depositary;
  - (b) a description of the way in which the safe-keeping and oversight function is to be performed depending on the types of assets and the geographical regions in which the AIF plans to invest. With respect to the custody duties this description shall include country lists and procedures for adding and, as the case may be, or withdrawing countries from that list. This shall be consistent

with the information provided in the AIF rules, instruments of incorporation and offering documents regarding the assets in which the AIF may invest;

- (c) a statement that the depositary's liability shall not be affected by any delegation of its custody functions unless it has discharged itself of its liability in accordance with Article 21(13) or (14) of Directive 2011/61/EU;
- (d) the period of validity and the conditions for amendment and termination of the contract including the situations which could lead to the termination of the contract and details regarding the termination procedure and, if applicable, the procedures by which the depositary should send all relevant information to its successor;
- (e) the confidentiality obligations applicable to the parties in accordance with relevant laws and regulations. These obligations shall not impair the ability of competent authorities to have access to the relevant documents and information;
- (f) the means and procedures by which the depositary transmits to the AIFM or the AIF all relevant information that it needs to perform its duties including the exercise of any rights attached to assets, and in order to allow the AIFM and the AIF to have a timely and accurate overview of the accounts of the AIF;
- (g) the means and procedures by which the AIFM or the AIF transmits all relevant information or ensures the depositary has access to all the information it needs to fulfil its duties, including the procedures ensuring that the depositary will receive information from other parties appointed by the AIF or the AIFM;
- (h) information on whether or not the depositary, or a third party to whom safe-keeping functions are delegated in accordance with Article 21(11) of Directive 2011/61/EU may re-use the assets it has been entrusted with and, if any, the conditions attached to any such re-use;
- (i) the procedures to be followed when an amendment to the AIF rules, instruments of incorporation or offering documents is being considered, detailing the situations in which the depositary is to be informed, or where the prior agreement of the depositary is needed to proceed with the amendment;
- (j) all necessary information that needs to be exchanged between the AIF, the AIFM, a third party acting on behalf of the AIF or the AIFM, on the one hand, and the depositary, on the other hand, related to the sale, subscription, redemption, issue, cancellation and re-purchase of units or shares of the AIF;
- (k) all necessary information that needs to be exchanged between the AIF, the AIFM, a third party acting on behalf of the AIF or the AIFM and the depositary related to the performance of the depositary's oversight and control function;
- (l) where the parties to the contract envisage appointing third parties to carry out parts of their respective duties, a commitment to provide, on a regular basis, details of any third party appointed and, upon request, information on the criteria used to select the third party and the steps envisaged to monitor the activities carried out by the selected third party;

- (m) information on the tasks and responsibilities of the parties to the contract in respect of obligations relating to the prevention of money laundering and the financing of terrorism;
  - (n) information on all cash accounts opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF and the procedures ensuring that the depositary will be informed when any new account is opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF;
  - (o) details regarding the depositary's escalation procedures, including the identification of the persons to be contacted within the AIF and, as the case may be, or the AIFM by the depositary when it launches such a procedure;
  - (p) a commitment by the depositary to notify the AIFM when it becomes aware that the segregation of assets is not, or is no longer sufficient to ensure protection from insolvency of a third party, to whom safe-keeping functions are delegated in accordance with Article 21(11) of Directive 2011/61/EU in a specific jurisdiction;
  - (q) the procedures ensuring that the depositary, in respect of its duties, has the ability to enquire into the conduct of the AIFM and, as the case may be, or the AIF and to assess the quality of information transmitted including by way of having access to the books of the AIF and, as the case may be, or AIFM or by way of on-site visits;
  - (r) the procedures ensuring that the AIFM and, as the case may be, or the AIF can review the performance of the depositary in respect of the depositary's contractual obligations.
2. The details of the means and procedures set out in points (a) to (r) shall be described in the contract appointing the depositary or any subsequent amendment to the contract.
  3. The contract appointing the depositary or the subsequent amendment to the contract referred to in paragraph 2 shall be done in writing.
  4. The parties may agree to transmit all or part of the information that flows between them electronically provided that proper recording of such information is ensured.
  5. Unless otherwise provided by national law, there shall be no obligation to enter into a specific written agreement for each AIF; it shall be possible for the AIFM and the depositary to enter into a framework agreement listing the AIFs managed by that AIFM to which the agreement applies.
  6. The national law applicable to the contract appointing the depositary and any subsequent agreement shall be specified.

## SECTION 2

### GENERAL CRITERIA FOR ASSESSING THE PRUDENTIAL REGULATION AND

**SUPERVISION APPLICABLE TO DEPOSITARIES IN THIRD COUNTRIES [ARTICLE  
21(6)(B) OF DIRECTIVE 2011/61/EU]**

*Article 84*

*Criteria for assessing prudential regulation and supervision applicable to a depositary in a  
third country*

For the purposes of point (b) of Article 21(6) of Directive 2011/61/EU, the effectiveness of prudential regulation and supervision applicable to a depositary in a third country whether it has the same effect as that provided for under Union law and its effective enforcement shall be assessed against the following criteria:

- (a) the depositary is subject to authorisation and on-going supervision by a public competent authority with adequate resources to fulfil its tasks;
- (b) the law of the third country lay down criteria for authorisation as a depositary that have the same effect as those laid down for access to the business of credit institutions or investment firms within the Union;
- (c) the capital requirements imposed on the depositary in the third country have the same effect as those applicable in the Union depending on whether the depositary is of the same nature as an Union credit institution or investment firm;
- (d) the operating conditions applicable to a depositary in the third country have the same effect as those laid down for credit institutions or investment firms within the Union depending on the nature of the depositary;
- (e) the requirements regarding the performance of the specific duties as AIF depositary established in the law of the third country have the same effect as those provided for in Article 21(7) to (15) of Directive 2011/61/EU and its implementing measures and the relevant national law;
- (f) the law of the third country provides for the application of sufficiently dissuasive enforcement actions in the event of breach by the depositary of the requirements and conditions referred to points (a) to (e).

**SECTION 3**

**DEPOSITARY FUNCTIONS, DUE DILIGENCE DUTIES AND SEGREGATION  
OBLIGATION [ARTICLE 21(7) – (9) AND ARTICLE 21(11)(C) AND (D)(III) OF  
DIRECTIVE 2011/61/EU]**

*Article 85*

*Cash monitoring – general requirements*

1. Where a cash account is maintained or opened at an entity referred to in Article 21(7) of Directive 2011/61/EU in the name of the AIF, in the name of the AIFM acting on



behalf of the AIF or in the name of the depositary acting on behalf of the AIF, an AIFM shall ensure that the depositary is provided, upon commencement of its duties and on an on-going basis, with all relevant information it needs to comply with its obligations.

2. In order to have access to all information regarding the AIF's cash accounts and have a clear overview of all the AIF's cash flows, a depositary shall at least:
  - (a) be informed, upon its appointment, of all existing cash accounts opened in the name of the AIF, or in the name of the AIFM acting on behalf of the AIF;
  - (b) be informed at the opening of any new cash account by the AIF or by the AIFM acting on behalf of the AIF;
  - (c) be provided with all information related to the cash accounts opened at a third party entity, directly by those third parties .

#### *Article 86*

#### *Monitoring of the AIF's cash flows*

A depositary shall ensure effective and proper monitoring of the AIF's cash flows and in particular it shall at least:

- (a) ensure that all cash of the AIF is booked in accounts opened with entities referred to in points (a), (b) and (c) of Article 18(1) of Directive 2006/73/EC in the relevant markets where cash accounts are required for the purposes of the AIF's operations and which are subject to prudential regulation and supervision that has the same effect as Union law, is effectively enforced and is in accordance with the principles laid down in Article 16 of Directive 2006/73/EC;
- (b) implement effective and proper procedures to reconcile all cash flow movements and perform such reconciliations on a daily basis or, in case of infrequent cash movements, when such cash flow movements occur;
- (c) implement appropriate procedures to identify at the close of business day significant cash flows and in particular those which could be inconsistent with the AIF's operations;
- (d) review periodically the adequacy of those procedures including through a full review of the reconciliation process at least once a year and ensuring that the cash accounts opened in the name of the AIF, in the name of the AIFM acting on behalf of the AIF or in the name of the depositary acting on behalf of the AIF are included in the reconciliation process;
- (e) monitor on an on-going basis the outcomes of the reconciliations and actions taken as a result of any discrepancies identified by the reconciliation procedures and notify the AIFM if an irregularity has not been rectified without undue delay and also the competent authorities if the situation cannot be clarified and, as the case may be, or corrected;

- (f) check the consistency of its own records of cash positions with those of the AIFM. The AIFM shall ensure that all instructions and information related to a cash account opened with a third party are sent to the depository, so that the depository is able to perform its own reconciliation procedure.

*Article 87*  
*Duties regarding subscriptions*

An AIFM shall ensure that the depository is provided with information about payments made by or on behalf of investors upon the subscription of units or shares of an AIF at the close of each business day when the AIFM, the AIF or a party acting on behalf of it, such as a transfer agent receives such payments or an order from the investor. The AIFM shall ensure that the depository receives all other relevant information it needs to make sure that the payments are then booked in cash accounts opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF or in the name of the depository in accordance with the provisions of Article 21(7) of Directive 2011/61/EU.

*Article 88*  
*Financial instruments to be held in custody*

1. Financial instruments belonging to the AIF or to the AIFM acting on behalf of the AIF which are not able to be physically delivered to the depository shall be included in the scope of the custody duties of the depository where all of the following requirements are met:
  - (a) they are transferable securities including those which embed derivatives as referred to in the last subparagraph of Article 51(3) of Directive 2009/65/EC and Article 10 of Directive 2007/16/EC, money market instruments or units of collective investment undertakings.
  - (b) they are capable of being registered or held in an account directly or indirectly in the name of the depository.
2. Financial instruments which, in accordance with applicable national law, are only directly registered in the name of the AIF with the issuer itself or its agent, such as a registrar or a transfer agent, shall not be held in custody.
3. Financial instruments belonging to the AIF or the AIFM acting on behalf of the AIF which are able to be physically delivered to the depository shall always be included in the scope of the custody duties of the depository.

*Article 89*  
*Safekeeping duties with regard to assets held in custody*

1. In order to comply with the obligations laid down in point (a) of Article 21(8) of Directive 2011/61/EU with respect to financial instruments to be held in custody, a depository shall ensure at least that:

- (a) the financial instruments are properly registered in accordance with Article 21(8) (a)(ii) of Directive 2011/61/EU;
  - (b) records and segregated accounts are maintained in a way that ensures their accuracy, and in particular record the correspondence with the financial instruments and cash held for AIFs;
  - (c) reconciliations are conducted on a regular basis between the depositary's internal accounts and records and those of any third party to whom custody functions are delegated in accordance with Article 21(11) of Directive 2011/61/EU;
  - (d) due care is exercised in relation to the financial instruments held in custody in order to ensure a high standard of investor protection;
  - (e) all relevant custody risks throughout the custody chain are assessed and monitored and the AIFM is informed of any material risk identified;
  - (f) adequate organisational arrangements are introduced to minimise the risk of loss or diminution of the financial instruments, or of rights in connection with those financial instruments as a result of fraud, poor administration, inadequate registering or negligence;
  - (g) the AIF's ownership right or the ownership right of the AIFM acting on behalf of the AIF over the assets is verified.
2. Where a depositary has delegated its custody functions to a third party in accordance with Article 21(11) of Directive 2011/61/EU, it shall remain subject to the requirements of points (b) to (e) of paragraph 1 of this Article. It shall also ensure that the third party complies with the requirements of points (b) to (g) of paragraph 1 of this Article and the segregation obligations laid down in Article 99.
  3. A depositary's safe-keeping duties as referred to in paragraphs 1 and 2 shall apply on a look-through basis to underlying assets held by financial and, as the case may be, or legal structures controlled directly or indirectly by the AIF or the AIFM acting on behalf of the AIF.

The requirement referred to in the first subparagraph shall not apply to fund of funds structures or master-feeder structures where the underlying funds have a depositary which keeps in custody the assets of these funds.

#### *Article 90*

##### *Safekeeping duties regarding ownership verification and record keeping*

1. An AIFM shall provide the depositary, upon commencement of its duties and on an ongoing basis, with all relevant information the depositary needs in order to comply with its obligations pursuant to point (b) of Article 21(8) of Directive 2011/61/EU, and ensure that the depositary is provided with all relevant information by third parties.

2. In order to comply with the obligations referred to in point (b) of Article 21(8) of Directive 2011/61/EU, a depositary shall at least:
  - (a) have access without undue delay to all relevant information it needs in order to perform its ownership verification and record-keeping duties, including relevant information to be provided to the depositary by third parties;
  - (b) possess sufficient and reliable information for it to be satisfied of the AIF's ownership right or of the ownership right of the AIFM acting on behalf of the AIF over the assets;
  - (c) maintain a record of those assets for which it is satisfied that the AIF or the AIFM acting on behalf of the AIF holds the ownership. In order to comply with this obligation, the depositary shall:
    - (i) register in its record, in the name of the AIF, assets, including their respective notional amounts, for which it is satisfied that the AIF or the AIFM acting on behalf of the AIF holds the ownership;
    - (ii) be able to provide at any time a comprehensive and up-to-date inventory of the AIF's assets, including their respective notional amounts.

For the purpose of point (c) (ii) of paragraph 2, the depositary shall ensure that there are procedures in place so that registered assets cannot be assigned, transferred, exchanged or delivered without the depositary or its delegate having been informed of such transactions and the depositary shall have access without undue delay to documentary evidence of each transaction and position from the relevant third party. The AIFM shall ensure that the relevant third party provides the depositary without undue delay with certificates or other documentary evidence every time there is a sale or acquisition of assets or a corporate action resulting in the issue of financial instruments and at least once a year.

3. In any event, a depositary shall ensure that the AIFM has and implements appropriate procedures to verify that the assets acquired by the AIF it manages are appropriately registered in the name of the AIF or in the name of the AIFM acting on behalf of the AIF, and to check the consistency between the positions in the AIFM's records and the assets for which the depositary is satisfied that the AIF or the AIFM acting on behalf of the AIF holds the ownership. The AIFM shall ensure that all instructions and relevant information related to the AIF's assets are sent to the depositary, so that the depositary is able to perform its own verification or reconciliation procedure.
4. A depositary shall set up and implement an escalation procedure for situations where an anomaly is detected including notification of the AIFM and of the competent authorities if the situation cannot be clarified and, as the case may be, or corrected.
5. A depositary's safe-keeping duties referred to in paragraphs 1 to 4 shall apply on a look-through basis to underlying assets held by financial and, as the case may be, or legal structures established by the AIF or by the AIFM acting on behalf of the AIF for the purposes of investing in the underlying assets and which are controlled directly or indirectly by the AIF or by the AIFM acting on behalf of the AIF.

The requirement referred to in the first subparagraph shall not apply to fund of funds structures and master-feeder structures where the underlying funds have a depositary which provides ownership verification and record-keeping functions for this fund's assets.

*Article 91*  
*Reporting obligations for prime brokers*

1. Where a prime broker has been appointed, the AIFM shall ensure that from the date of that appointment an agreement is in place pursuant to which the prime broker is required to make available to the depositary in particular a statement in a durable medium which contains the following information:
  - (a) the values of the items listed in paragraph 3 at the close of each business day ;
  - (b) details of any other matters necessary to ensure that the depositary of the AIF has up-to-date and accurate information about the value of assets the safekeeping of which has been delegated in accordance with Article 21(11) of Directive 2011/61.
2. The statement referred to in paragraph 1 shall be made available to the depositary of the AIF no later than the close of the next business day to which it relates.
3. The items referred to in point (a) of paragraph 1 shall include:
  - (a) the total value of assets held by the prime broker for the AIF, where safe-keeping functions are delegated in accordance with Article 21(11) of Directive 2011/61/EU,
    - (i) the value of each of the following:
    - (ii) cash loans made to the AIF and accrued interest;
    - (iii) securities to be redelivered by the AIF under open short positions entered into on behalf of the AIF;
    - (iv) current settlement amounts to be paid by the AIF under any futures contracts;
    - (v) short sale cash proceeds held by the prime broker in respect of short positions entered into on behalf of the AIF;
    - (vi) cash margins held by the prime broker in respect of open futures contracts entered into on behalf of the AIF. This obligation is in addition to the obligations under Articles 87 and 88;
    - (vii) mark-to-market close-out exposures of any OTC transaction entered into on behalf of the AIF;
    - (viii) total secured obligations of the AIF against the prime broker; and
    - (ix) all other assets relating to the AIF;

- (b) the value of other assets referred to in point (b) of Article 21(8) of Directive 2011/61/EU held as collateral by the prime broker in respect of secured transactions entered into under a prime brokerage agreement;
- (c) the value of the assets where the prime broker has exercised a right of use in respect of the AIF's assets;
- (d) a list of all the institutions at which the prime broker holds or may hold cash of the AIF in an account opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF in accordance with Article 21(7) of Directive 2011/61/EU.

#### *Article 92*

#### *Oversight duties – general requirements*

1. At the time of its appointment, the depositary shall assess the risks associated with the nature, scale and complexity of the AIF's strategy and the AIFM's organisation in order to devise oversight procedures which are appropriate to the AIF and the assets in which it invests and which are then implemented and applied. Such procedures shall be regularly updated.
2. In performing its oversight duties under Article 21(9) of Directive 2011/61/EU, a depositary shall perform ex-post controls and verifications of processes and procedures that are under the responsibility of the AIFM, the AIF or an appointed third party. The depositary shall in all circumstances ensure that an appropriate verification and reconciliation procedure exists which is implemented and applied and frequently reviewed. The AIFM shall ensure that all instructions related to the AIF's assets and operations are sent to the depositary, so that the depositary is able to perform its own verification or reconciliation procedure.
3. A depositary shall establish a clear and comprehensive escalation procedure to deal with situations where potential irregularities are detected in the course of its oversight duties, the details of which shall be made available to the competent authorities of the AIFM upon request.
4. An AIFM shall provide the depositary, upon commencement of its duties and on an on-going basis, with all relevant information it needs in order to comply with its obligations pursuant to Article 21(9) of Directive 2011/61/EU including information to be provided to the depositary by third parties. The AIFM shall particularly ensure that the depositary is able to have access to the books and perform on-site visits on premises of the AIFM and of those of any service provider appointed by the AIF or the AIFM, such as administrators or external valuers and, as the case may be, or to review reports and statements of recognised external certifications by qualified independent auditors or other experts in order to ensure the adequacy and relevance of the procedures in place.

*Article 93*  
*Duties regarding subscription and redemptions*

In order to comply with point (a) of Article 21(9) of Directive 2011/61/EU the depositary shall meet the following requirements:

- (1) The depositary shall ensure that the AIF, the AIFM or the designated entity has established, implements and applies an appropriate and consistent procedure to:
  - (i) reconcile the subscription orders with the subscription proceeds, and the number of units or shares issued with the subscription proceeds received by the AIF;
  - (ii) reconcile the redemption orders with the redemptions paid, and the number of units or shares cancelled with the redemptions paid by the AIF;
  - (iii) verify on a regular basis that the reconciliation procedure is appropriate.

For the purpose of points (i), (ii) and (iii), the depositary shall in particular regularly check the consistency between the total number of units or shares in the AIF's accounts and the total number of outstanding shares or units that appear in the AIF's register.

- (2) A depositary shall ensure and regularly check that the procedures regarding the sale, issue, repurchase, redemption and cancellation of shares or units of the AIF comply with the applicable national law and with the AIF rules or instruments of incorporation and verify that these procedures are effectively implemented.
- (3) The frequency of the depositary's checks shall be consistent with the frequency of subscriptions and redemptions.

*Article 94*  
*Duties regarding the valuation of shares/units*

1. In order to comply with point (b) of Article 21(9) of Directive 2011/61/EU the depositary shall:
  - (a) verify on an on-going basis that appropriate and consistent procedures are established and applied for the valuation of the assets of the AIF in compliance with Article 19 of Directive 2011/61/EU and its implementing measures and with the AIF rules and instruments of incorporation; and
  - (b) ensure that the valuation policies and procedures are effectively implemented and periodically reviewed.
2. A depositary's procedures shall be conducted at a frequency consistent with the frequency of the AIF's valuation policy as defined in Article 19 of Directive 2011/61/EU and its implementing measures.
3. Where a depositary considers that the calculation of the value of the shares or units of the AIF has not been performed in compliance with applicable law or the AIF

rules or with Article 19 of Directive 2011/61/EU, it shall notify the AIFM and, as the case may be, or the AIF and ensure that timely remedial action is taken in the best interest of the investors in the AIF.

4. Where an external valuer has been appointed, a depositary shall check that the external valuer's appointment is in accordance with Article 19 of Directive 2011/61/EU and its implementing measures.

#### *Article 95*

##### *Duties regarding the carrying out of the AIFM's instructions*

In order to comply with point (c) of Article 21(9) of Directive 2011/61/EU the depositary shall at least:

- (a) set up and implement appropriate procedures to verify that the AIF and AIFM comply with applicable laws and regulations and with the AIF's rules and instruments of incorporation. In particular, the depositary shall monitor the AIF's compliance with investment restrictions and leverage limits set in the AIF's offering documents. Those procedures shall be proportionate to the nature, scale and complexity of the AIF;
- (b) set up and implement an escalation procedure where the AIF has breached one of the limits or restrictions referred to in point (a).

#### *Article 96*

##### *Duties regarding the timely settlement of transactions*

1. In order to comply with point (d) of Article 21(9) of Directive 2011/61/EU the depositary shall set up a procedure to detect any situation where a consideration related to the operations involving the assets of the AIF or of the AIFM acting on behalf of the AIF is not remitted to the AIF within the usual time limits, notify the AIFM and, where the situation has not been remedied, request the restitution of the financial instruments from the counterparty where possible.
2. Where transactions do not take place on a regulated market, the usual time limits shall be assessed with regard to the conditions attached to the transactions (OTC derivative contracts or investments in real estate assets or in privately held companies).

#### *Article 97*

##### *Duties related to the AIF's income distribution*

1. In order to comply with point (e) of Article 21(9) of Directive 2011/61/EU the depositary shall:
  - (a) ensure that the net income calculation, once declared by the AIFM, is applied in accordance with the AIF rules, instruments of incorporation and applicable national law;



- (b) ensure that appropriate measures are taken where the AIF's auditors have expressed reserves on the annual financial statements. The AIF or the AIFM acting on behalf of the AIF shall provide the depositary with all information on reserves expressed on the financial statements; and
  - (c) check the completeness and accuracy of dividend payments, once they are declared by the AIFM, and, where relevant, of the carried interest.
2. Where a depositary considers that the income calculation has not been performed in compliance with applicable law or with the AIF rules or instruments of incorporation, it shall notify the AIFM and, as the case may be, or the AIF and ensure that timely remedial action has been taken in the best interest of the AIF's investors.

*Article 98*  
*Due diligence*

1. In order to fulfil the obligations laid down in point (c) of Article 21(11) of Directive 2011/61/EU a depositary shall implement and apply an appropriate documented due diligence procedure for the selection and on-going monitoring of the delegate. That procedure shall be reviewed regularly, at least once a year, and made available upon request to competent authorities.
2. When selecting and appointing a third party, to whom safekeeping functions are delegated in accordance with Article 21(11) of Directive 2011/61/EU, a depositary shall exercise all due skill, care and diligence to ensure that entrusting financial instruments to this third party provides an adequate standard of protection. It shall at least :
- (a) assess the regulatory and legal framework, including country risk, custody risk and the enforceability of the third party's contracts. That assessment shall in particular enable the depositary to determine the potential implication of an insolvency of the third party for the assets and rights of the AIF. If a depositary becomes aware that the segregation of assets is not sufficient to ensure protection from insolvency because of the law of the country where the third party is located, it shall immediately inform the AIFM;
  - (b) assess whether the third party's practice, procedures and internal controls are adequate to ensure that the financial instruments of the AIF or of the AIFM acting on behalf of the AIF are subject to a high standard of care and protection;
  - (c) assess whether the third party's financial strength and reputation are consistent with the tasks delegated. That assessment shall be based on information provided by the potential third party as well as other data and information, where available.
  - (d) ensure that the third party has the operational and technological capabilities to perform the delegated custody tasks with a satisfactory degree of protection and security.

3. A depositary shall exercise all due skill, care and diligence in the periodic review and on-going monitoring to ensure that the third party continues to comply with the criteria provided for in paragraph 1 of this Article and the conditions set out in point (d) of Article 21(11) of Directive 2011/61/EU. To this end the depositary shall at least:
  - (a) monitor the third party's performance and its compliance with the depositary's standards;
  - (b) ensure that the third party exercises a high standard of care, prudence and diligence in the performance of its custody tasks and in particular that it effectively segregates the financial instruments in line with the requirements of Article 99;
  - (c) review the custody risks associated with the decision to entrust the assets to the third party and without undue delay notify the AIF or AIFM of any change in those risks. That assessment shall be based on information provided by the third party and other data and information where available. During market turmoil or when a risk has been identified, the frequency and the scope of the review shall be increased. If the depositary becomes aware that the segregation of assets is no longer sufficient to ensure protection from insolvency because of the law of the country where the third party is located, it shall immediately inform the AIFM.
4. Where the third party further delegates any of the functions delegated to it, the conditions and criteria set out in paragraphs 1, 2 and 3 shall apply mutatis mutandis.
5. A depositary shall monitor compliance with Article 21(4) of Directive 2011/61/EU.
6. A depositary shall devise contingency plans for each market in which it appoints a third party in accordance with Article 21(11) of Directive 2011/61/EU to perform safekeeping duties. Such a contingency plan shall include the identification of an alternative provider, if any.
7. A depositary shall take measures, including termination of the contract, which are in the best interest of the AIF and its investors where the delegate no longer complies with the requirements.

*Article 99*  
*Segregation obligation*

1. Where safekeeping functions have been delegated wholly or partly to a third party, a depositary shall ensure that the third party, to whom safe-keeping functions are delegated pursuant to Article 21(11) of Directive 2011/61/EU, acts in accordance with the segregation obligation laid down in point (iii) of Article 21(11)(d) of Directive 2011/61/EU by verifying that the third party:
  - (a) keeps such records and accounts as are necessary to enable it at any time and without delay to distinguish assets of the depositary's AIF clients from its own assets, assets of its other clients, assets held by the depositary for its own account and assets held for clients of the depositary which are not AIFs;

- (b) maintains records and accounts in a way that ensures their accuracy, and in particular their correspondence to the assets safe-kept for the depositary's clients;
  - (c) conducts, on a regular basis, reconciliations between its internal accounts and records and those of the third party to whom it has delegated safe-keeping functions in accordance with the third subparagraph of Article 21(11) of Directive 2011/61/EU;
  - (d) introduces adequate organisational arrangements to minimise the risk of loss or diminution of financial instruments or of rights in connection with those financial instruments as a result of misuse of the financial instruments, fraud, poor administration, inadequate record-keeping or negligence;
  - (e) Where the third party is an entity referred to in points (a), (b) and (c) of Article 18(1) of Directive 2006/73/EC which is subject to effective prudential regulation and supervision that has the same effect as Union law and is effectively enforced, the depositary shall take the necessary steps to ensure that the AIF's cash is held in an account or accounts in accordance with Article 21(7) of Directive 2011/61/EU.
2. Where a depositary has delegated its custody functions to a third party in accordance with Article 21(11) of Directive 2011/61/EU, the monitoring of the third party's compliance with its segregation obligations shall ensure that the financial instruments belonging to its clients are protected from any insolvency of that third party. If, according to the applicable law, including in particular the law relating to property or insolvency, the requirements laid down in paragraph 1 are not sufficient to achieve that objective, the depositary shall assess what additional arrangements are to be made in order to minimise the risk of loss and maintain an adequate standard of protection.
3. Paragraphs 1, and 2 shall apply *mutatis mutandis* when the third party, to whom safe-keeping functions are delegated in accordance with Article 21(11) of Directive 2011/61/EU, has decided to delegate all or part of its safe-keeping functions to another third party pursuant to the third subparagraph of Article 21(11) of Directive 2011/61/EU.

#### **SECTION 4**

#### **LOSS OF FINANCIAL INSTRUMENTS, LIABILITY DISCHARGE AND OBJECTIVE REASONS [ARTICLE 21(12) AND (13) OF DIRECTIVE 2011/61/EU]**

##### *Article 100*

##### *Loss of a financial instrument held in custody*

1. A loss of a financial instrument held in custody within the meaning of Article 21(12) of Directive 2011/61/EU shall be deemed to have taken place when, in relation to a financial instrument held in custody by the depositary or by a third party to whom the

custody of financial instruments held in custody has been delegated, any of the following conditions is met:

- (a) a stated right of ownership of the AIF is demonstrated not to be valid because it either ceased to exist or never existed;
  - (b) the AIF has been definitively deprived of its right of ownership over the financial instrument;
  - (c) the AIF is definitively unable to directly or indirectly dispose of the financial instrument.
2. The ascertainment by the AIFM of the loss of a financial instrument shall follow a documented process readily available to the competent authorities. Once a loss is ascertained, it shall be notified immediately to investors in a durable medium.
  3. A financial instrument held in custody shall not be deemed to be lost within the meaning of Article 21(12) of Directive 2011/61/EU where an AIF is definitively deprived of its right of ownership in respect of a particular instrument, but this instrument is substituted by or converted into another financial instrument or instruments.
  4. In the event of insolvency of the third party to whom the custody of financial instruments held in custody has been delegated, the loss of a financial instrument held in custody shall be ascertained by the AIFM as soon as one of the conditions listed in paragraph 1 is met with certainty.

There shall be certainty as to whether any of the conditions set out in paragraph 1 is fulfilled at the latest at the end of the insolvency proceedings. The AIFM and the depositary shall monitor closely the insolvency proceedings to determine whether all or some of the financial instruments entrusted to the third party to whom the custody of financial instruments has been delegated are effectively lost.

5. A loss of a financial instrument held in custody shall be ascertained irrespective of whether the conditions listed in paragraph 1 are the result of fraud, negligence or other intentional or non-intentional behaviour.

#### *Article 101*

##### *Liability discharge under Article 21(12) of Directive 2011/61/EU*

1. A depositary's liability under the second subparagraph of Article 21(12) of Directive 2011/61/EU shall not be triggered provided the depositary can prove that all the following conditions are met:
  - (a) the event which led to the loss is not the result of any act or omission of the depositary or of a third party to whom the custody of financial instruments held in custody in accordance with point (a) of Article 21(8) of Directive 2011/61/EU has been delegated;

- (b) the depositary could not have reasonably prevented the occurrence of the event which led to the loss despite adopting all precautions incumbent on a diligent depositary as reflected in common industry practice;
- (c) despite rigorous and comprehensive due diligence, the depositary could not have prevented the loss.

This condition may be deemed to be fulfilled when the depositary has ensured that the depositary and the third party to whom the custody of financial instruments held in custody in accordance with point (a) of Article 21(8) of Directive 2011/61/EU has been delegated have taken all of the following actions:

- (i) establishing, implementing, applying and maintaining structures and procedures and insuring expertise that are adequate and proportionate to the nature and complexity of the assets of the AIF in order to identify in a timely manner and monitor on an ongoing basis external events which may result in loss of a financial instrument held in custody;
- (ii) assessing on an ongoing basis whether any of the events identified under the first indent presents a significant risk of loss of a financial instrument held in custody;
- (iii) informing the AIFM of the significant risks identified and taking appropriate actions, if any, to prevent or mitigate the loss of financial instruments held in custody, where actual or potential external events have been identified which are believed to present a significant risk of loss of a financial instrument held in custody.

2. The requirements referred to in points (a) and (b) of paragraph 1 may be deemed to be fulfilled in the following circumstances:

- (a) natural events beyond human control or influence;
- (b) the adoption of any law, decree, regulation, decision or order by any government or governmental body, including any court or tribunal, which impacts the financial instruments held in custody;
- (c) war, riots or other major upheavals.

3. The requirements referred to in points (a) and (b) of paragraph 1 shall not be deemed to be fulfilled in cases such as an accounting error, operational failure, fraud, failure to apply the segregation requirements at the level of the depositary or a third party to whom the custody of financial instruments held in custody in accordance with point (a) of Article 21(8) of Directive 2011/61/EU has been delegated.

4. This Article shall apply *mutatis mutandis* to the delegate when the depositary has contractually transferred its liability in accordance with Article 21(13) and (14) of Directive 2011/61/EU.

## *Article 102*

### *Objective reasons for the depositary to contract a discharge of liability*

1. The objective reasons for contracting a discharge pursuant to Article 21(13) of Directive 2011/61/EU shall be:
  - (a) limited to precise and concrete circumstances characterising a given activity;
  - (b) consistent with the depositary's policies and decisions.
2. The objective reasons shall be established each time the depositary intends to discharge itself of liability.
3. The depositary shall be deemed to have objective reasons for contracting the discharge of its liability in accordance with Article 21(13) of Directive 2011/61/EU when the depositary can demonstrate that it had no other option but to delegate its custody duties to a third party. In particular, this shall be the case where:
  - (a) the law of a third country requires that certain financial instruments be held in custody by a local entity and local entities exist that satisfy the delegation criteria laid down in Article 21(11) of Directive 2011/61/EU; or
  - (b) the AIFM insists on maintaining an investment in a particular jurisdiction despite warnings by the depositary as to the increased risk this presents.

## **Chapter V**

### **Transparency requirements, leverage, rules relating to third countries and exchange of information on the potential consequences of AIFM activity**

#### **SECTION 1**

#### **ANNUAL REPORT, DISCLOSURE TO INVESTORS AND REPORTING TO COMPETENT AUTHORITIES [ARTICLES 22(2)(A) TO (E), 23(4) AND 24(1) OF DIRECTIVE 2011/61/EU]**

## *Article 103*

### *General principles for the annual report*

All information provided in the annual report, including the information specified in this Section, shall be presented in a manner that provides materially relevant, reliable, comparable and clear information. The annual report shall contain the information investors need in relation to particular AIF structures.

*Article 104*

*Content and format of the balance sheet or statement of assets and liabilities and of the income and expenditure account*

1. The balance sheet or statement of assets and liabilities shall contain at least the following elements and underlying line items in accordance with point (a) of Article 22(2) of Directive 2011/61/EU:
  - (a) ‘assets’ comprising the resources controlled by the AIF as a result of past events and from which future economic benefits are expected to flow to the AIF. Assets shall be sub-classified according to the following line items:
    - (i) ‘investments’, including, but not limited to, debt and equity securities, real estate and property and derivatives;
    - (ii) ‘cash and cash equivalents’, including, but not limited to, cash-in-hand, demand deposits and qualifying short-term liquid investments;
    - (iii) ‘receivables’, including, but not limited to, amounts receivable in relation to dividends and interest, investments sold, amounts due from brokers and ‘prepayments’, including, but not limited to, amounts paid in advance in relation to expenses of the AIF,
  - (b) ‘liabilities’, comprising present obligations of the AIF arising from past events, the settlement of which is expected to result in an outflow from the AIF of resources embodying economic benefits. Liabilities shall be sub-classified according to the following line items:
    - (i) ‘payables’, including, but not limited to, amounts payable in relation to the purchase of investments or redemption of units or shares in the AIF and amounts due to brokers and ‘accrued expenses’, including, but not limited to, liabilities for management fees, advisory fees, performance fees, interest and other expenses incurred in the course of operations of the AIF;
    - (ii) ‘borrowings’, including, but not limited to, amounts payable to banks and other counterparties;
    - (iii) ‘other liabilities’, including, but not limited to, amounts due to counterparties for collateral on return of securities loaned, deferred income and dividends and distributions payable;
  - (c) ‘net assets’, representing the residual interest in the assets of the AIF after deducting all its liabilities.
2. The income and expenditure account shall contain at least the following elements and underlying line items:
  - (a) ‘income’, representing any increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in net assets other than those

relating to contributions from investors. Income shall be sub-classified according to the following line items:

- (i) 'investment income', which can be further sub-classified as follows:
    - 'dividend income', relating to dividends on equity investments to which the AIF is entitled;
    - 'interest income', relating to interest on debt investments and on cash to which the AIF is entitled;
    - 'rental income', relating to rental income from property investments to which the AIF is entitled;
  - (ii) 'realised gains on investments', representing gains on the disposal of investments;
  - (iii) 'unrealised gains on investments', representing gains on the revaluation of investments; and
  - (iv) 'other income' including, but not limited to, fee income from securities loaned and from miscellaneous sources.
- (b) 'expenses', representing decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in net assets, other than those relating to distributions to investors. Expenses shall, be sub-classified according to the following line items:
- 'investment advisory or management fees', representing contractual fees due to the advisor or AIFM;
  - 'other expenses', including, but not limited to, administration fees, professional fees, custodian fees and interest. Individual items, if material in nature, should be disclosed separately;
  - 'realised loss on investments', representing loss on the disposal of investments;
  - 'unrealised loss on investments', representing loss on the revaluation of investments;
- (c) 'net income or expenditure', representing the excess of income over expenditure or expenditure over income, as applicable.
3. The layout, nomenclature and terminology of line items shall be consistent with the accounting standards applicable to or the rules adopted by the AIF, and shall comply with legislation applicable where the AIF is established. Such line items may be amended or extended to ensure compliance with the above.
4. Additional line items, headings and subtotals shall be presented when such presentation is relevant to the understanding of an AIF's financial position in the



balance sheet or statement of assets and liabilities or an AIF's financial performance in the content and format of the income and expenditure account. Where relevant additional information shall be presented in the notes to the financial statements. The purpose of the notes shall be to provide narrative descriptions or disaggregation of items presented in the primary statements and information about items that do not qualify for recognition in these statements.

5. Each material class of similar items shall be presented separately. Individual items, if material, shall be disclosed. Materiality shall be assessed under the requirements of the accounting framework adopted.
6. The presentation and classification of items in the balance sheet or statement of assets and liabilities shall be retained from one reporting or accounting period to the next unless it is apparent that another presentation or classification would be more appropriate, as when a shift in the investment strategy leads to different trading patterns, or because an accounting standard has required a change in presentation.
7. With respect to the content and format of the income and expenditure account set out to in Annex IV, all items of income and expense shall be recognised in a given period in the income and expenditure account unless an accounting standard adopted by the AIF requires otherwise.

#### *Article 105*

#### *Report on the activities of the financial year*

1. The report on activities of the financial year shall include at least:
  - (a) an overview of investment activities during the year or period, and an overview of the AIF's portfolio at year-end or period end;
  - (b) an overview of AIF performance over the year or period;
  - (c) material changes as defined below in the information listed in Article 23 of Directive 2011/61/EU not already present in the financial statements.
2. The report shall include a fair and balanced review of the activities and performance of the AIF, containing also a description of the principal risks and investment or economic uncertainties that the AIF might face.
3. To the extent necessary for an understanding of the AIF's investment activities or its performance, the analysis shall include both financial and non-financial key performance indicators relevant to that AIF. The information provided in the report shall be consistent with national rules where the AIF is established.
4. The information in the report on the activities of the financial year shall form part of the directors or investment managers report insofar as this is usually presented alongside the financial statements of the AIF.

*Article 106*  
*Material changes*

1. Any changes in information shall be deemed material within the meaning of point (d) of Article 22(2) of Directive 2011/61/EU if there is a substantial likelihood that a reasonable investor, becoming aware of such information, would reconsider its investment in the AIF, including because such information could impact an investor's ability to exercise its rights in relation to its investment, or otherwise prejudice the interests of one or more investors in the AIF.
2. In order to comply with point (d) of Article 22(2) of Directive 2011/61/EU, AIFMs shall assess changes in the information referred to in Article 23 of Directive 2011/61/EU during the financial year in accordance with paragraph 1 of this Article.
3. Information shall be disclosed in line with the requirements of the accounting standards and accounting rules adopted by the AIF together with a description of any potential or anticipated impact on the AIF and, as the case may be, on investors in the AIF. Additional disclosures shall be made when compliance with specific requirements of the accounting standards and accounting rules may be insufficient to enable investors to understand the impact of the change.
4. Where the information required to be disclosed in accordance with paragraph 1 is not covered by the accounting standards applicable to an AIF, or its accounting rules, a description of the material change shall be provided together with any potential or anticipated impact on the AIF and, as the case may be, on investors in the AIF.

*Article 107*  
*Remuneration disclosure*

1. When information required by point (e) of Article 22(2) of Directive 2011/61/EU is given, it shall be specified whether or not the total remuneration relates to any of the following:
  - (a) the total remuneration of the entire staff of the AIFM, indicating the number of beneficiaries;
  - (b) the total remuneration of those staff of the AIFM who are fully or partly involved in the activities of the AIF, indicating the number of beneficiaries;
  - (c) the proportion of the total remuneration of the staff of the AIFM attributable to the AIF, indicating the number of beneficiaries.
2. Where relevant, the total remuneration for the financial year shall also mention the carried interest paid by the AIF.
3. Where information is disclosed at the level of the AIFM, an allocation or breakdown shall be provided in relation to each AIF, insofar as this information exists or is readily available. As part of this disclosure, a description of how the allocation or breakdown has been provided shall be included.

4. AIFMs shall provide general information relating to the financial and non-financial criteria of the remuneration policies and practices for relevant categories of staff to enable investors to assess the incentives created. In accordance with the principles set out in Annex II of Directive 2011/61/EU, AIFMs shall disclose at least the information necessary to provide an understanding of the risk profile of the AIF and the measures it adopts to avoid or manage conflicts of interest.

*Article 108*  
*Periodic disclosure to investors*

1. The information referred to in Article 23(4) of Directive 2011/61/EU shall be presented in a clear and understandable way.
2. When disclosing the percentage of the AIF's assets which are subject to special arrangements arising from their illiquid nature in accordance with Article 23(4)(a) of Directive 2011/61/EU the AIFM shall:
  - (a) provide an overview of any special arrangements in place including whether they relate to side pockets, gates or other similar arrangements, the valuation methodology applied to assets which are subject to such arrangements and how management and performance fees apply to these assets;
  - (b) disclose this information as part of the AIF's periodic reporting to investors, as required by the AIF's rules or instruments of incorporation, or at the same time as the prospectus and offering document and — as a minimum — at the same time as the annual report is made available in accordance with Article 22(1) of Directive 2011/61/EU.

The percentage of the AIF's assets which are subject to special arrangements as defined in Article 1(5) shall be calculated as the net value of those assets subject to special arrangements divided by the net asset value of the AIF concerned.

3. For any new arrangements for managing the liquidity of the AIF in accordance with point (b) of Article 23(4) of Directive 2011/61/EU AIFMs shall:
  - (a) for each AIF that they manage which is not an unleveraged closed-ended AIF, notify to investors whenever they make changes to the liquidity management systems and procedures referred to in Article 16(1) of Directive 2011/61/EU which are material in accordance with Article 106(1);
  - (b) immediately notify investors where they activate gates, side pockets or similar special arrangements or where they decide to suspend redemptions;
  - (c) provide an overview of the changes to arrangements concerning liquidity, whether or not these are special arrangements. Where relevant, the terms under which redemption is permitted and circumstances determining when management discretion applies shall be included. Also any voting or other restrictions exercisable, the length of any lock-up or any provision concerning 'first in line' or 'pro-rating' on gates and suspensions shall be included.

4. The disclosure of the risk profile of the AIF in accordance with point (c) of Article 23(4) of Directive 2011/61/EU shall outline:
  - (a) measures to assess the sensitivity of the AIF's portfolio to the most relevant risks to which the AIF is or could be exposed;
  - (b) if risk limits set by the AIFM have been or are likely to be exceeded and where these risk limits have been exceeded a description of the circumstances and, the remedial measures taken;

The information shall be disclosed as part of the AIF's periodic reporting to investors, as required by the AIF's rules or instruments of incorporation or at the same time as the prospectus and offering document and – at a minimum – at the same time as the annual report is made available in accordance with Article 22(1) of Directive 2011/61/EU.

5. The risk management systems employed by the AIFM in accordance with point (c) of Art. 23(4) of Directive 2011/61/EU shall outline the main features of the risk management systems employed by the AIFM to manage the risks to which each AIF it manages is or may be exposed. In the case of a change the disclosure shall include the information relating to the change and its anticipated impact on the AIF and its investors.

The information shall be disclosed as part of the AIF's periodic reporting to investors, as required by the AIF's rules or instruments of incorporation or at the same time as the prospectus and offering document and – as a minimum – at the same time as the annual report is made available or made public in accordance with Article 22(1) of Directive 2011/61/EU.

*Article 109*  
*Regular disclosure to investors*

1. The information referred to in Article 23(5) of Directive 2011/61/EU shall be presented in a clear and understandable way.
2. Information on changes to the maximum level of leverage calculated in accordance with the gross and commitment methods and any right of re-use of collateral or any guarantee under the leveraging arrangements shall be provided without undue delay and shall include:
  - (a) the original and revised maximum level of leverage calculated in accordance with Articles 7 and 8, whereby the level of leverage shall be calculated as the relevant exposure divided by the net asset value of the AIF;
  - (b) the nature of the rights granted for the reuse of collateral;
  - (c) the nature of guarantees granted and
  - (d) details of changes in any service providers which relating to one of the items above.

3. Information on the total amount of leverage calculated in accordance with the gross and commitment methods employed by the AIF shall be disclosed as part of the AIF's periodic reporting to investors, as required by the AIF's rules or instruments of incorporation, or at the same time as the prospectus and offering document and at least at the same time as the annual report is made available according to Article 22(1) of Directive 2011/61/EU.

*Article 110*  
*Reporting to competent authorities*

1. In order to comply with the requirements of the second subparagraph of Article 24(1) and of point (d) of Article 3(3) of Directive 2011/61/EU, an AIFM shall provide the following information when reporting to competent authorities:
  - (a) the main instruments in which it is trading, including a break-down of financial instruments and other assets, including the AIF's investment strategies and their geographical and sectoral investment focus;
  - (b) the markets of which it is a member or where it actively trades;
  - (c) the diversification of the AIF's portfolio, including, but not limited to, its principal exposures and most important concentrations.

The information shall be provided as soon as possible and not later than one month after the end of the period referred to in paragraph 3. Where the AIF is a fund of funds this period may be extended by the AIFM by 15 days.

2. For each of the EU AIFs they manage and for each of the AIFs they market in the Union, AIFMs shall provide to the competent authorities of their home Member State the following information in accordance with Article 24(2) of Directive 2011/61/EU:
  - (a) the percentage of the AIF's assets which are subject to special arrangements as defined in Article 1(5) of this Regulation arising from their illiquid nature as referred to in point (a) of Article 23(4) of Directive 2011/61/EU;
  - (b) any new arrangements for managing the liquidity of the AIF;
  - (c) the risk management systems employed by the AIFM to manage the market risk, liquidity risk, counterparty risk and other risks including operational risk;
  - (d) the current risk profile of the AIF, including:
    - (i) the market risk profile of the investments of the AIF, including the expected return and volatility of the AIF in normal market conditions;
    - (ii) the liquidity profile of the investments of the AIF, including the liquidity profile of the AIF's assets, the profile of redemption terms and the terms of financing provided by counterparties to the AIF;

- (e) information on the main categories of assets in which the AIF invested including the corresponding short market value and long market value, the turnover and performance during the reporting period; and
  - (f) the results of periodic stress tests, under normal and exceptional circumstances, performed in accordance with point (b) of Article 15(3) and the second subparagraph of Article 16(1) of Directive 2011/61/EU.
3. The information referred to in paragraphs 1 and 2 shall be reported as follows:
- (a) on a half-yearly basis by AIFMs managing portfolios of AIFs whose assets under management calculated in accordance with Article 2 in total exceed the threshold of either EUR 100 million or EUR 500 million laid down in points (a) and (b) respectively of Article 3(2) of Directive 2011/61/EU but do not exceed EUR 1 billion, for each of the EU AIFs they manage and for each of the AIFs they market in the Union;
  - (b) on a quarterly basis by AIFMs managing portfolios of AIFs whose assets under management calculated in accordance with Article 2 in total exceed EUR 1 billion, for each of the EU AIFs they manage, and for each of the AIFs they market in the Union;
  - (c) on a quarterly basis by AIFMs which are subject to the requirements referred to in point (a) of this paragraph, for each AIF whose assets under management, including any assets acquired through use of leverage, in total exceed EUR 500 million, in respect of that AIF;
  - (d) on an annual basis by AIFMs in respect of each unleveraged AIF under their management which, in accordance with its core investment policy, invests in non-listed companies and issuers in order to acquire control .
4. By way of derogation from paragraph 3, the competent authority of the home Member State of the AIFM may deem it appropriate and necessary for the exercise of its function to require all or part of the information to be reported on a more frequent basis.
5. AIFMs managing one or more AIFs which they have assessed to be employing leverage on a substantial basis in accordance with Article 111 of this Regulation shall provide the information required under Article 24(4) of Directive 2011/61/EU at the same time as that required under paragraph 2 of this Article.
6. AIFMs shall provide the information specified under paragraphs 1, 2 and 5 in accordance with the pro-forma reporting template set out in the Annex IV.
7. In accordance with point (a) of Article 42(1) of Directive 2011/61/EU, for non-EU AIFMs, any reference to the competent authorities of the home Member State shall mean the competent authority of the Member State of reference.

*Article 111*  
*Use of leverage on a 'substantial basis'*

1. Leverage shall be considered to be employed on a substantial basis for the purposes of Article 24(4) of Directive 2011/61/EU when the exposure of an AIF as calculated according to the commitment method under Article 8 of this Regulation exceeds three times its net asset value.
2. Where the requirements referred to in paragraph 1 of this Article are fulfilled, AIFMs shall provide information in accordance with Article 24(4) of Directive 2011/61/EU to the competent authorities of their home Member States in accordance with the principles laid down in Article 110(3) of this Regulation.

**SECTION 2**  
**AIFMs MANAGING LEVERAGED AIFs [ARTICLE 25(3) OF DIRECTIVE**  
**2011/61/EU]**

*Article 112*  
*Restrictions on the management of AIFs*

1. The principles laid down in this Article shall apply in order to specify the circumstances in which competent authorities exercise their power to impose leverage limits or other restrictions on AIFMs.
2. When assessing the information received under Articles 7(3), 15(4), 24(4) or 24(5) of Directive 2011/61/EU, a competent authority shall take into account the extent to which the use of leverage by an AIFM or its interaction with a group of AIFMs or other financial institutions can contribute to the build-up of systemic risk in the financial system or risks creating disorderly markets.
3. Competent authorities shall take into account at least the following aspects in their assessment:
  - (a) the circumstances in which the exposure of an AIF or several AIFs including those exposures resulting from financing or investment positions entered into by the AIFM for its own account or on behalf of the AIFs could constitute an important source of market, liquidity or counterparty risk to a financial institution;
  - (b) the circumstances in which the activities of an AIFM or its interaction with, for example, a group of AIFMs or other financial institutions, in particular with respect to the types of assets in which the AIF invests and the techniques employed by the AIFM through the use of leverage, contribute or could contribute to a downward spiral in the prices of financial instruments or other assets in a manner that threatens the viability of such financial instruments or other assets;

- (c) criteria such as the type of AIF, the investment strategy of the AIFM with respect to the AIFs concerned, the market conditions in which the AIFM and the AIF operate and any likely pro-cyclical effects that could result from the imposition by the competent authorities of limits or other restrictions on the use of leverage by the AIFM concerned;
- (d) criteria, such as the size of an AIF or several AIFs and any related impact in a particular market sector, concentrations of risks in particular markets in which the AIF or several AIFs are investing, any contagion risk to other markets from a market where risks have been identified, liquidity issues in particular markets at a given time, the scale of asset/liability mismatch in a particular AIFM investment strategy or irregular movements in the prices of assets in which an AIF may invest.

### SECTION 3

#### **SPECIFIC RULES RELATING TO THIRD COUNTRIES [ARTICLES 34(1), 35(2) 36(1), 37(7)(D), 40(2)(A) AND 42(1) OF DIRECTIVE 2011/61/EU]**

##### *Article 113*

##### *General requirements*

1. Cooperation arrangements shall cover all possible situations and actors envisaged in Chapter VII of Directive 2011/61/EU taking into account the location of the AIFM, the location of the AIF and the activity of the AIFM.
2. Cooperation arrangements shall take a written form.
3. Cooperation arrangements shall establish the specific framework for consultation, cooperation and exchange of information for supervisory and enforcement purposes between EU competent authorities and third country supervisory authorities.
4. Cooperation arrangements shall include a specific clause providing for the transfer of information received by a Union competent authority from a supervisory authority in a third country to other Union competent authorities, to ESMA or to the ESRB as required under Directive 2011/61/EU.

##### *Article 114*

##### *Mechanisms, instruments and procedures*

1. Cooperation arrangements shall establish the mechanisms, instruments and procedures required for enabling Union competent authorities to have access to all information necessary for the performance of their duties under Directive 2011/61/EU.
2. Cooperation arrangements shall establish the mechanisms, instruments and procedures required for enabling on-site inspections to be carried out where required for the exercise of the Union competent authority's duties under Directive 2011/61/EU. On-site inspections shall be carried out directly by the Union competent



authority or by the third country competent authority with the assistance of the Union competent authority.

3. Cooperation arrangements shall establish the mechanisms, instruments and procedures required for the third country competent authority to assist the Union competent authorities where it is necessary to enforce Union legislation and national implementing legislation breached by an entity established in the third country, in accordance with the national and international law applicable to that authority.

*Article 115*  
*Data protection*

Cooperation arrangements shall ensure that the transfer to third countries of data and the analysis of data takes place only in accordance with Article 52 of Directive 2011/61/EU.

**SECTION 4**  
**EXCHANGE OF INFORMATION ON THE POTENTIAL SYSTEMIC CONSEQUENCES OF AIFM ACTIVITY [ARTICLE 53(1) OF DIRECTIVE 2011/61/EU]**

*Article 116*  
*Exchange of information on the potential systemic consequences of AIFM activity*

For the purposes of Article 53 of Directive 2011/61/EU, the competent authorities of the Member States responsible for the authorisation or supervision of AIFMs under that Directive shall exchange with the competent authorities of other Member States, and with ESMA and the ESRB at least:

- (a) the information received pursuant to Article 110, whenever such information may be relevant for monitoring and responding to the potential implications of the activities of individual AIFMs or several AIFMs collectively for the stability of systemically relevant financial institutions and the orderly functioning of markets on which the AIFMs are active;
- (b) the information received from third country authorities whenever this is necessary for the monitoring of systemic risks;
- (c) the analysis of the information referred to in points (a) and (b) and the assessment of any situation in which the activities of one or more supervised AIFMs or of one or more AIFs under their management are considered to contribute to the build-up of systemic risk in the financial system, to the risk of disorderly markets or to risks for the long-term growth of the economy;
- (d) the measures taken, when the activity of one or more supervised AIFMs or of one or more AIFs under their management present systemic risk or jeopardise the orderly functioning of the markets on which they are active.

## **Chapter VI**

### **Final provisions**

#### *Article 117* *Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall apply from 22 July 2013.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 19.12.2012

*For the Commission*  
*The President*  
*José Manuel BARROSO*

## ANNEX I

### Methods of increasing the exposure of an AIF

1. Unsecured cash borrowings: When cash borrowings are invested they have the propensity to increase the exposure of the AIF by the total amount of those borrowings. Therefore, the minimum exposure is always the amount of the borrowing. It might be higher if the value of the investment realised with the borrowing is greater than the borrowed amount. To avoid double counting, cash borrowings that are used to finance the exposure shall not be included within the calculation. If the cash borrowings are not invested but remain in cash or cash equivalent as defined in Article 7(a) they will not increase the exposure of the AIF.
2. Secured cash borrowings: Secured cash borrowings are similar to unsecured cash borrowings but the loan may be secured by a pool of assets or a single asset. If the cash borrowings are not invested but remain in cash or cash equivalent as defined in Article 7(a) they will not increase the exposure of the AIF
3. Convertible borrowings: Convertible borrowings are purchased debt which has the ability, under certain circumstances, to enable the holder or issuer to convert that debt into another asset. The exposure of the AIF is the market value of such borrowings.
4. Interest rate swaps: An interest rate swap is an agreement to exchange interest rate cash flows, calculated on a notional principal amount, at specified intervals (payment dates) during the life of the agreement. Each party's payment obligation is computed using a different interest rate based on the notional exposures.
5. Contracts for differences: A contract for differences (CFD) is an agreement between two parties — the investor and the CFD provider — to pay the other the change in the price of an underlying asset. Depending on which way the price moves, one party pays the other the difference from the time the contract was agreed to the point in time where it ends. Exposure is the market value of the underlying asset. The same treatment must be applied to financial spread bets.
6. Futures contracts: A futures contract is an agreement to buy or sell a stated amount of a security, currency, commodity, index or other asset at a specific future date and at a pre-agreed price. The exposure is the market value of the equivalent underlying asset.
7. Total return swaps: A total return swap is an agreement in which one party (total return payer) transfers the total economic performance of a reference obligation to the other party (total return receiver). Total economic performance includes income from interest and fees, gains or losses from market movements, and credit losses. The exposure of the AIF is the market value of the equivalent reference assets which have a bearing on the economic performance of the swap.
8. Forward agreements: A forward agreement is a customised, bilateral agreement to exchange an asset or cash flows at a specified future settlement date at a forward price agreed on the trade date. One party to the forward is the buyer (long), who agrees to pay the forward price on the settlement date; the other is the seller (short),

who agrees to receive the forward price. Entering into a forward contract typically does not require the payment of a fee. The exposure of the AIF is the market value of the equivalent underlying asset. This may be replaced by the notional value of the contract where this is more conservative.

9. Options: An option is an agreement that gives the buyer, who pays a fee (premium), the right — but not the obligation — to buy or sell a specified amount of an underlying asset at an agreed price (strike or exercise price) on or until the expiration of the contract (expiry). A call option is an option to buy, and a put option an option to sell. The bounds of the exposure of the fund will be on the one side a potential unlimited exposure and on the other side an exposure that is limited to the higher of the premium paid or the market value of that option. The exposure between these two bounds is determined as the delta (an options delta measures the sensitivity of an option's price solely to a change in the price of the underlying asset) adjusted equivalent of the underlying position. The same approach must be adopted for embedded derivatives, e.g. in structured products. The structure should be broken down into its component parts and the effect of layers of derivative exposures must be adequately captured.
10. Repurchase agreements: The repurchase agreement normally occurs where an AIF 'sells' securities to a reverse-repo counterparty and agrees to buy them back at an agreed price in the future. The AIF will incur a financing cost from engaging in this transaction and will therefore need to re-invest the cash proceeds (effectively cash collateral) in order to generate a return greater than the financing cost incurred. This reinvestment of 'cash collateral' means that incremental market risk will be carried by the AIF and consequently must be taken into account in the global exposure calculation. The economic risks and rewards of the 'sold' securities remain with the AIF. Also, a repo transaction will almost always give rise to leverage as the cash collateral will be reinvested. In the event that non-cash collateral is received as part of the transaction and this collateral is further used as part of another repo, or stock-loan agreement, the full market value of the collateral must be included in the global exposure amount. The exposure of the AIF is increased by the reinvested part of the cash collateral.
11. Reverse repurchase agreements: This transaction occurs where an AIF 'purchases' securities from a repo counterparty and agrees to sell them back at an agreed price in the future. AIFs normally engage in these transactions to generate a low-risk money-market type return, and the 'purchased' securities act as collateral. Therefore no global exposure is generated; nor does the AIF take on the risks and rewards of the 'purchased' securities, i.e. there is no incremental market risk. However, it is possible for the 'purchased' securities to be further used as part of a repo or security-loan transaction, as described above, and in that case the full market value of the securities must be included in the global exposure amount. The economic risks and rewards of the purchased securities remain with the counterparty and therefore this does not increase the exposure of the AIF.
12. Securities lending arrangements: An AIF engaging in a securities lending transaction will lend a security to a security-borrowing counterparty (who will normally borrow the security to cover a physical short sale transaction) for an agreed fee. The security borrower will deliver either cash or non-cash collateral to the AIF. Only where cash collateral is reinvested in instruments other than those defined in Article 7 point (a)

will global exposure be created. If the non-cash collateral is further used as part of a repo or another security lending transaction, the full market value of the securities must be included in the global exposure amount as described above. Exposure is created to the extent that the cash collateral has been reinvested.

13. Securities borrowing arrangements: An AIF engaging in the borrowing of securities will borrow a security from a security-lending counterparty for an agreed fee. The AIF will then sell the security in the market. The AIF is now short that security. To the extent that the cash proceeds from the sale are reinvested this will also increase the exposure of the AIF. Exposure is the market value of the shorted securities; additional exposure is created to the extent that the cash received is reinvested.
14. Credit default swaps: A credit default swap (CDS) is a credit derivative agreement that gives the buyer protection, usually the full recovery, in case the reference entity defaults or suffers a credit event. In return the seller of the CDS receives from the buyer a regular fee, called the spread. For the protection seller, the exposure is the higher of the market value of the underlying reference assets or the notional value of the credit default swap. For the protection buyer, the exposure is the market value of the underlying reference asset.

## ANNEX II

### Conversion methodologies for derivative instruments

1. The following conversion methods shall be applied to the non-exhaustive list below of standard derivatives:
  - (a) Futures
    - Bond future: Number of contracts \* notional contract size \* market price of the cheapest-to-deliver reference bond
    - Interest rate future: Number of contracts \* notional contract size
    - Currency future: Number of contracts \* notional contract size
    - Equity future: Number of contracts \* notional contract size \* market price of underlying equity share
    - Index futures: Number of contracts \* notional contract size \* index level
  - (b) Plain vanilla options (bought/sold puts and calls)
    - Plain vanilla bond option: Notional contract value \* market value of underlying reference bond \* delta
    - Plain vanilla equity option: Number of contracts \* notional contract size \* market value of underlying equity share \* delta
    - Plain vanilla interest rate option: Notional contract value \* delta
    - Plain vanilla currency option: Notional contract value of currency leg(s) \* delta
    - Plain vanilla index options: Number of contracts \* notional contract size \* index level \* delta
    - Plain vanilla options on futures: Number of contracts \* notional contract size \* market value of underlying asset \* delta
    - Plain vanilla swaptions: Reference swap commitment conversion amount \* delta
    - Warrants and rights: Number of shares/bonds \* market value of underlying referenced instrument \* delta
  - (c) Swaps
    - Plain vanilla fixed/floating rate interest rate and inflation swaps: notional contract value

- Currency swaps: Notional value of currency leg(s)
- Cross currency interest rate swaps: Notional value of currency leg(s)
- Basic total return swap: Underlying market value of reference asset(s)
- Non-basic total return swap: Cumulative underlying market value of both legs of the TRS
- Single name credit default swap:
 

Protection seller - The higher of the market value of the underlying reference asset or the notional value of the Credit Default Swap.

Protection buyer – Market value of the underlying reference asset
- Contract for differences: Number of shares/bonds \* market value of underlying referenced instrument

(d) Forwards

- FX forward: notional value of currency leg(s)
- Forward rate agreement: notional value

(e) Leveraged exposure to indices with embedded leverage

A derivative providing leveraged exposure to an underlying index, or indices that embed leveraged exposure to their portfolio, must apply the standard applicable commitment approach to the assets in question.

2. The following conversion methods shall be applied to the non-exhaustive list below of financial instruments which embed derivatives

- Convertible bonds: Number of referenced shares \* market value of underlying referenced shares \* delta
- Credit linked notes: Market value of underlying reference asset(s)
- Partly paid securities: Number of shares/bonds \* market value of underlying referenced instruments
- Warrants and rights: Number of shares/bonds \* market value of underlying referenced instrument \* delta

3. List of examples of non-standard derivatives with the related commitment methodology being used:

- Variance swaps: Variance swaps are contracts that allow investors to gain exposure to the variance (squared volatility) of an underlying asset and, in particular, to trade future realised (or historical) volatility against current implied volatility. According to market practice, the strike and the variance

notional are expressed in terms of volatility. For the variance notional, this gives:

$$\text{variance notional} = \frac{\text{vega notional}}{2 \times \text{strike}}$$

The vega notional provides a theoretical measure of the profit or loss resulting from a 1% change in volatility.

As realised volatility cannot be less than zero, a long swap position has a known maximum loss. The maximum loss on a short swap is often limited by the inclusion of a cap on volatility. However without a cap, a short swap's potential losses are unlimited.

The conversion methodology to be used for a given contract at time t is:

Variance notional \* (current) variance<sub>t</sub> (without volatility cap)

Variance notional \* min [(current) variance<sub>t</sub>; volatility cap<sup>2</sup>] (with volatility cap)

whereby: (current) variance<sub>t</sub> is a function of the squared realized and implied volatility, more precisely:

$$(\text{current}) \text{ variance}_t = \frac{t}{T} * \text{realized volatility}(0,t)^2 + \frac{T-t}{T} * \text{implied volatility}(t,T)^2$$

– Volatility swaps

By analogy with the variance swaps, the following conversion formulae should be applied to volatility swaps:

– Vega notional \* (current) volatility<sub>t</sub> (without volatility cap)

– Vega notional \* min [(current) volatility<sub>t</sub>; volatility cap] (with volatility cap)

whereby the (current) volatility t is a function of the realized and implied volatility.

4. Barrier (knock-in knock-out) options

Number of contracts \* notional contract size \* market value of underlying equity share \* delta



## ANNEX III

### Duration netting rules

1. An interest rate derivative shall be converted into its equivalent underlying asset position in accordance with the following methodology:

The equivalent underlying asset position of each interest rate derivative instrument shall be calculated as its duration divided by the target duration of the AIF and multiplied by the equivalent underlying asset position:

$$\text{Equivalent underlying asset position} = \frac{\text{duration}_{\text{FDI}}}{\text{duration}_{\text{target}}} \times \text{CV}_{\text{derivative}}$$

where:

- $\text{duration}_{\text{FDI}}$  is the duration (sensitivity of the market value of the financial derivative instrument to interest rate movements) of the interest rate derivative instrument;
- $\text{duration}_{\text{target}}$  is in line with the investment strategy, the directional positions and the expected level of risk at any time and will be regularised otherwise. It is also in line with the portfolio duration under normal market conditions;
- $\text{CV}_{\text{derivative}}$  is the converted value of the derivative position as defined by the Annex II.

2. The equivalent underlying asset positions calculated in accordance with to paragraph 1 shall be netted as follows:

- (a) Each interest rate derivative instrument shall be allocated to the appropriate maturity range of the following maturity-based ladder:

Maturities ranges

1. 0 - 2 years
2. 2 - 7 years
3. 7 - 15 years
4. > 15 years

- (b) The long and short equivalent underlying asset positions shall be netted within each maturity range. The amount of the former which is netted with the latter is the netted amount for that maturity range.

- (c) Starting with the shortest maturity range, the netted amounts between two adjoining maturity ranges shall be calculated by netting the amount of the remaining unnetted long (or short) position in the maturity range (i) with the

amount of the remaining unnetted short (long) position in the maturity range (i+ 1).

- (d) Starting with the shortest maturity range, the netted amounts between two remote maturity ranges separated by another one shall be calculated by netting the amount of the remaining unnetted long (or short) position in the maturity range (i) with the amount of the remaining unnetted short (long) position in the maturity range (i + 2).
- (e) The netted amount shall be calculated between the remaining unnetted long and short positions of the two most remote maturity ranges.

3. The AIF shall calculate its exposures as the sum of absolute values:

- 0% of the netted amount for each maturity range;
- 40% of the netted amounts between two adjoining maturity ranges (i) and (i+1);
- 75% of the netted amounts between two remote maturity ranges separated by another one, meaning maturity ranges (i) and (i+2);
- 100% of the netted amounts between the two most remote maturity ranges; and
- 100% of the remaining unnetted positions.

**ANNEX IV**

**REPORTING TEMPLATES: AIFM**  
**(Articles 3 (3)(d) and 24 of Directive 2011/61/EU)**

<b>AIFM-SPECIFIC INFORMATION TO BE REPORTED</b> (Article 3(3)(d) and Article 24(1) of Directive 2011/61/EU)					
	<b>Most important market/instrument</b>	<b>Second most important market/instrument</b>	<b>Third most important market/instrument</b>	<b>Fourth most important market/instrument</b>	<b>Fifth most important market/instrument</b>
<b>1</b>	<b>Principal markets in which it trades on behalf of the AIFs it manages</b>				
<b>2</b>	<b>Principal instruments in which it trades on behalf of the AIFs it manages</b>				
<b>3</b>	<b>Values of assets under management for all AIFs managed, calculated as set out in Article 2</b>	<b>In base currency (if the same for all AIFs)</b>			
		<b>In EUR</b>			
Please provide official name, location and jurisdiction of markets					

<b>DETAILED LIST OF ALL AIFs WHICH THE AIFM MANAGES</b> to be provided on request for the end of each quarter (Article 24(3) of Directive 2011/61/EU)					
<b>Name of the AIF</b>	<b>Fund identification code</b>	<b>Inception date</b>	<b>AIF type</b> (Hedge Fund, Private Equity, Real Estate, Fund of Funds, Other*)	<b>NAV</b>	<b>EU AIF:</b> Yes/No



**REPORTING TEMPLATES: AIF**  
(Article 3 (3)(d) and Article 24 of Directive 2011/61/EU)

<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED</b> (Article 3(3)(d) and Article 24(1) of Directive 2011/61/EU)		<b>Reported Data</b>
<b>Data Type</b>	<b>IDENTIFICATION OF THE AIF</b>	
<b>1 AIF name</b>		EU AIF: yes/no
<b>2 Fund manager</b> <i>(Legal name and standard code, where available)</i>		EU AIFM: yes/no
<b>3 Fund identification codes,</b> as applicable		
<b>4 Inception date of the AIF</b>		
<b>5 Domicile of the AIF</b>		
<b>6 Identification of prime broker(s) of the AIF</b> <i>(Legal name and standard code, where available)</i>		
<b>7 Base currency of the AIF according to ISO 4217 and assets under management calculated as set out in Article 2</b>		Currency Total AuM
<b>8 Jurisdictions of the three main funding sources</b> (excluding units or shares of the AIF bought by investors)		
<b>9 Predominant AIF type</b> <i>(select one)</i>		Hedge Fund Private Equity Fund Real Estate Fund Fund of Funds Other None
<b>10 Breakdown of investment strategies</b> <i>(Provide a breakdown of the investment strategies of the AIF depending on the predominant AIF type selected in question 1. See guidance notes for further information on how to complete this question.)</i>		
	Indicate the strategy that best describe the AIF's strategy	Share in NAV (%)

<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED</b> (Article 3(3)(d) and Article 24(1) of Directive 2011/61/EU)		
	<b>Data Type</b>	<b>Reported Data</b>
<p><b>a) Hedge Fund Strategies</b> (Complete this question if you selected 'Hedge Fund' as the predominant AIF type in question 1.) Indicate the hedge fund strategies that best describe the AIF's strategies</p> <p>Equity: Long Bias Equity: Long / Short Equity: Market Neutral Equity: Short Bias Relative Value: Fixed Income Arbitrage Relative Value: Convertible Bond Arbitrage Relative Value: Volatility Arbitrage Event Driven: Distressed / Restructuring Event Driven: Risk Arbitrage / Merger Arbitrage Event Driven: Equity Special Situations Credit Long / Short Credit Asset Based Lending Macro Managed Futures / CTA: Fundamental Managed Futures / CTA: Quantitative Multi-strategy hedge fund Other hedge fund strategy</p>		
<p><b>b) Private Equity Strategies</b> (Complete this question if you selected 'Private Equity' as the predominant AIF type in question 1.) Indicate the private equity strategies that best describe the AIF's strategies</p> <p>Venture Capital Growth Capital Mezzanine Capital Multi-strategy private equity fund Other private equity fund strategy</p>		
<p><b>c) Real Estate Strategies</b> (Complete this question if you selected 'Real Estate' as the predominant AIF type in question 1.) Indicate the real estate strategies that best describe the AIF's strategies</p> <p>Residential real estate Commercial real estate Industrial real estate</p>		

<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED</b> (Article 3(3)(d) and Article 24(1) of Directive 2011/61/EU)			
	<b>Data Type</b>		<b>Reported Data</b>
	Multi-strategy real estate fund Other real estate strategy		
	<b>d) Fund of Fund Strategies</b> <i>(Complete this question if you selected 'Fund of Funds' as the predominant AIF type in question 1.)</i> <i>Indicate the 'fund of fund' strategy that best describe the AIFs strategies</i> Fund of hedge funds Fund of private equity Other fund of funds		
	<b>e) Other Strategies</b> <i>(Complete this question if you selected 'Other' as the predominant AIF type in question 1.)</i> <i>Indicate the 'other' strategy that best describe the AIFs' strategies</i> Commodity fund Equity fund Fixed income fund Infrastructure fund Other fund		
<b>PRINCIPAL EXPOSURES AND MOST IMPORTANT CONCENTRATION</b>			
<b>11</b>	<b>Main instruments in which the AIF is trading</b>		
	Type of instrument/instrument code	Value (as calculated under Article 3 AIFMD)	Long / short position
	Most important instrument		
	2 <sup>nd</sup> most important instrument		
	3 <sup>rd</sup> most important instrument		
	4 <sup>th</sup> most important instrument		
	5 <sup>th</sup> most important instrument		
<b>12</b>	<b>Geographical focus</b>		
	Provide a geographical breakdown of the investments held by the AIF by percentage of the total net asset value of the AIF	% of NAV	
	Africa		
	Asia and Pacific (other than Middle East)		
	Europe (EEA)		

<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED</b> (Article 3(3)(d) and Article 24(1) of Directive 2011/61/EU)									
<b>Data Type</b>								<b>Reported Data</b>	
Europe (other than EEA)									
Middle East									
North America									
South America									
Supranational / multiple region									
<b>13 10 principal exposures of the AIF at the reporting date (most valuable in absolute terms):</b>									
	Type of asset/liability	Name/description of the asset/liability	Value (as calculated under Article 3)	% of gross market value	Long/short position	Counterparty (where relevant)			
1 <sup>st</sup>									
2 <sup>nd</sup>									
3 <sup>rd</sup>									
4 <sup>th</sup>									
5 <sup>th</sup>									
6 <sup>th</sup>									
7 <sup>th</sup>									
8 <sup>th</sup>									
9 <sup>th</sup>									
10 <sup>th</sup>									
<b>14 5 most important portfolio concentrations:</b>									
	Type of asset/liability	Name/description of the market	Value of aggregate exposure (as calculated under Article 3)	% of gross market value	Long / short position	Counterparty (where relevant)			
1 <sup>st</sup>									
2 <sup>nd</sup>									
3 <sup>rd</sup>									
4 <sup>th</sup>									
5 <sup>th</sup>									
<b>15 Typical deal/position size</b> (Complete this question if you selected as your predominant AIF type 'private equity fund' in question 1)									
									[Select one] Very small Small



<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED</b> (Article 3(3)(d) and Article 24(1) of Directive 2011/61/EU)	
Data Type	Reported Data
	Lower mid market Upper mid market Large cap Mega cap
<b>16 Principal markets in which AIF trades</b>	
<i>Please enter name and identifier (e.g. MIC code) where available, of market with greatest exposure</i>	
<i>Please enter name and identifier (e.g. MIC code) where available, of market with second greatest exposure</i>	
<i>Please enter name and identifier (e.g. MIC code) where available, of market with third greatest exposure</i>	
<b>17 Investor Concentration</b>	
Specify the approximate percentage of the AIF's equity that is beneficially owned by the five beneficial owners that have the largest equity interest in the AIF (as a percentage of outstanding units/ shares of the AIF; <b>look-through to the beneficial owners where known or possible</b> )	
Breakdown of investor concentration by status of investors (estimate if no precise information available):	%
- Professional clients (as defined in Directive 2004/39/EC (MiFID):	
- Retail investors:	
Monetary values should be reported in the base currency of the AIF.	

<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED TO COMPETENT AUTHORITIES</b> (Article 24(2) of Directive 2011/61/EU)	
Data Type	Reported Data
<b>IDENTIFICATION OF THE AIF</b>	
<b>1 AIF name</b>	EU AIF: yes/no
<b>2 Fund manager</b>	EU AIFM: yes/no
<b>1 AIF name</b>	
<b>2 Fund manager</b>	
<b>3 Fund identification codes, as applicable</b>	
<b>4 Inception date of the AIF</b>	
<b>5 Base currency of the AIF according to ISO 4217 and assets under management calculated as set out in Article 2</b>	Currency
<b>6 Identification of prime broker(s) of the AIF</b>	Total AuM
<b>7 Jurisdictions of the three main funding sources</b>	

<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED TO COMPETENT AUTHORITIES</b> (Article 24(2) of Directive 2011/61/EU)		
	<b>Data Type</b>	<b>Reported Data</b>
<b>INSTRUMENTS TRADED AND INDIVIDUAL EXPOSURES</b>		
<b>8</b>	<b>Individual Exposures in which it is trading and the main categories of assets in which the AIF invested as at the reporting date:</b>	
	<b>a) Securities</b>	<i>Long Value</i>
	Cash and cash equivalents	<i>Short Value</i>
	<i>Of which are:</i>	
	Certificates of deposit	
	Commercial papers	
	Other deposits	
	Other cash and cash equivalents (excluding government securities)	
	Listed equities	
	<i>Of which are:</i>	
	Issued by financial institutions	
	Other listed equity	
	Unlisted equities	
	Corporate bonds not issued by financial institutions	
	<i>Of which are:</i>	
	Investment grade	
	Non-investment grade	
	Corporate bonds issued by financial institutions	
	<i>Of which are:</i>	
	Investment grade	
	Non-investment grade	
	Sovereign bonds	
	<i>Of which are:</i>	
	EU bonds with a 0-1-year term to maturity	
	EU bonds with a 1+year term to maturity	
	Non-G10 bonds with a 0-1-year term to maturity	
	Non-G10 bonds with a 1+year term to maturity	
	Convertible bonds not issued by financial institutions	
	<i>Of which are:</i>	
	Investment grade	
	Non-investment grade	
	Convertible bonds issued by financial institutions	
	<i>Of which are:</i>	
	Investment grade	
	Non-investment grade	
	Loans	

AIF-SPECIFIC INFORMATION TO BE PROVIDED TO COMPETENT AUTHORITIES (Article 24(2) of Directive 2011/61/EU)		
	Data Type	Reported Data
	<i>Leveraged loans</i>	
	<i>Other loans</i>	
Structured/securitised products		
<i>Of which are:</i>	<i>ABS</i>	
	<i>RMBS</i>	
	<i>CMBS</i>	
	<i>Agency MBS</i>	
	<i>ABCP</i>	
	<i>CDO/CLO</i>	
	<i>Structured certificates</i>	
	<i>ETP</i>	
	<i>Other</i>	
<b>b) Derivatives</b>		
Equity derivatives		<i>Long Value</i>
<i>Of which are:</i>	<i>Related to financial institutions</i>	
	<i>Other equity derivatives</i>	
Fixed income derivatives		
CDS		
<i>Of which are:</i>	<i>Single name financial CDS</i>	
	<i>Single name sovereign CDS</i>	
	<i>Single name other CDS</i>	
	<i>Index CDS</i>	
	<i>Exotic (incl. credit default tranche)</i>	
		<i>Gross Value</i>
Foreign exchange (for investment purposes)		
Interest rate derivatives		
		<i>Long Value</i>
Commodity derivatives		
<i>Of which are:</i>	<i>Energy</i>	
	<i>Of which: - Crude oil</i>	
	<i>- Natural gas</i>	
	<i>- Power</i>	
	<i>Precious metals</i>	
		<i>Short Value</i>

<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED TO COMPETENT AUTHORITIES</b> (Article 24(2) of Directive 2011/61/EU)		
	<b>Data Type</b>	<b>Reported Data</b>
	<i>Of which: Gold</i>	
	<i>Other commodities</i>	
	<i>Of which: -Industrial metals</i>	
	<i>- Livestock</i>	
	<i>- Agricultural products</i>	
	Other derivatives	
	<b>c) Physical (Real / Tangible) Assets</b>	<i>Long Value</i>
	Physical: Real estate	
	<i>Of which are:</i>	
	Residential real estate	
	Commercial real estate	
	Physical: Commodities	
	Physical: Timber	
	Physical: Art and collectables	
	Physical: Transportation assets	
	Physical: Other	
	<b>d) Collective Investment Undertakings</b>	<i>Long Value</i>
	Investments in CIU operated/managed by the AIFM	
	<i>Of which are:</i>	
	<i>Money Market Funds and Cash management CIU</i>	
	<i>ETF</i>	
	<i>Other CIU</i>	
	Investments in CIU not operated/managed by the AIFM	
	<i>Of which are:</i>	
	<i>Money Market Funds and Cash management CIU</i>	
	<i>ETF</i>	
	<i>Other CIU</i>	
	<b>e) Investments in other asset classes</b>	<i>Long Value</i>
	Total Other	<i>Short Value</i>
<b>9</b>	<b>Value of turnover in each asset class over the reporting months</b>	
	<b>a) Securities</b>	<i>Market Value</i>
	Cash and cash equivalents	
	Listed equities	
	Unlisted equities	
	Corporate bonds not issued by financial institutions	

<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED TO COMPETENT AUTHORITIES</b> (Article 24(2) of Directive 2011/61/EU)		
	<b>Data Type</b>	<b>Reported Data</b>
	<i>Of which are:</i>	
	<i>Investment grade</i>	
	<i>Non-investment grade</i>	
	Corporate bonds issued by financial institutions	
	Sovereign bonds	
	<i>Of which are:</i>	
	<i>EU Member State bonds</i>	
	<i>Non EU Member State bonds</i>	
	Convertible bonds	
	Loans	
	Structured/secured products	
	<b>b) Derivatives</b>	<i>Notional Value</i>
	Equity derivatives	<i>Market Value</i>
	Fixed income derivatives	
	CDS	
	Foreign exchange (for investment purposes)	
	Interest rate derivatives	
	Commodity derivatives	
	Other derivatives	
	<b>c) Physical (Real / Tangible) Assets</b>	<i>Market Value</i>
	Physical: Commodities	
	Physical: Real estate	
	Physical: Timber	
	Physical: Art and collectables	
	Physical: Transportation assets	
	Physical: Other	
	<b>d) Collective investment undertakings</b>	
	<b>e) Other asset classes</b>	
	<b>Currency of Exposures</b>	
<b>10</b>	<b>Total long and short value of exposures (before currency hedging) by the following currency groups:</b>	<i>Long Value</i>
	AUD	<i>Short Value</i>
	CAD	
	CHF	
	EUR	

AIF-SPECIFIC INFORMATION TO BE PROVIDED TO COMPETENT AUTHORITIES (Article 24(2) of Directive 2011/61/EU)		
	Data Type	Reported Data
	GBP	
	HKD	
	JPY	
	USD	
	Other	
<b>11</b>	<b>Typical deal/position size</b> (Complete this question if you selected as your predominant AIF type 'private equity fund' above)	<i>[Select one]</i>  Very small (<€5m) Small (€5m to < €25m) Low / mid market (€25m to < €150m) Upper mid market (€150m to €500m) Large cap (€500m to €1bn) Mega cap (€1bn and greater)
<b>12</b>	<b>Dominant Influence [see Article 1 of Directive 83/349/EEC]</b> (Complete this question if you selected as your predominant AIF type 'private equity fund' above; please complete for each company over which the AIF has a dominant influence (leave blank if none) as defined in Article 1 of Directive 83/349/EEC)	Name
		% Voting Rights
		Transaction Type
	<b>RISK PROFILE OF THE AIF</b>	
	<b>1. MARKET RISK PROFILE</b>	
<b>13</b>	Expected annual investment return/IRR in normal market conditions (in %)	
	Net Equity Delta	
	Net DV01:	
	Net CS01 :	

AIF-SPECIFIC INFORMATION TO BE PROVIDED TO COMPETENT AUTHORITIES (Article 24(2) of Directive 2011/61/EU)		
	Data Type	Reported Data
	<b>2. COUNTERPARTY RISK PROFILE</b>	
<b>14</b>	<b>Trading and clearing mechanisms</b>	
	<b>a) Estimated % (in terms of market value) of securities traded:</b> <i>(leave blank if no securities traded)</i>	%
	On a regulated exchange	
	OTC	
	<b>b) Estimated % (in terms of trade volumes) of derivatives that are traded:</b> <i>(leave blank if no derivatives traded)</i>	%
	On a regulated exchange	
	OTC	
	<b>c) Estimated % (in terms of trade volumes) of derivatives transactions cleared:</b> <i>(leave blank if no derivatives traded)</i>	%
	By a CCP	
	Bilaterally	
	<b>d) Estimated % (in terms of market value) of repo trades cleared:</b> <i>(leave blank if no repos traded)</i>	%
	By a CCP	
	Bilaterally	
	Tri-party	
<b>15</b>	<b>Value of collateral and other credit support that the AIF has posted to all counterparties</b>	
	<b>a) Value of collateral posited in the form of cash and cash equivalents</b>	
	<b>b) Value of collateral posited in the form of other securities (excluding cash and cash equivalents)</b>	
	<b>c) Value of other collateral and credit support posted (including face amount of letters of credit and similar third party credit support)</b>	
<b>16</b>	<b>Of the amount of collateral and other credit support that the reporting fund has posted to counterparties: what percentage has been re-hypothecated by counterparties?</b>	
<b>17</b>	<b>Top Five Counterparty Exposures (excluding CCPs)</b>	
	<b>a) Identify the top five counterparties to which the AIF has the greatest mark-to-market net counterparty credit exposure, measured as a % of the NAV of the AIF</b>	<i>Name</i>
	Counterparty 1	<i>Total Exposure</i>
	Counterparty 2	
	Counterparty 3	

<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED TO COMPETENT AUTHORITIES</b> (Article 24(2) of Directive 2011/61/EU)							
	<b>Data Type</b>	<b>Reported Data</b>					
	Counterparty 4						
	Counterparty 5						
<b>b)</b>	<b>Identify the top five counterparties that have the greatest mark-to-market net counterparty credit exposure to the AIF, measured as a percentage of the NAV of the AIF.</b>	<i>Name</i>			<i>Total Exposure</i>		
	Counterparty 1						
	Counterparty 2						
	Counterparty 3						
	Counterparty 4						
	Counterparty 5						
<b>18</b>	<b>Direct clearing through central clearing counterparties (CCPs)</b>						
	a) During the reporting period, did the AIF clear any transactions directly through a CCP?	Yes No (if no, skip remainder of the question and go to question 21)			<i>Value held</i>		
<b>b)</b>	<b>If you answered 'yes' in 18(a), identify the top three central clearing counterparties (CCPs) in terms of net credit exposure</b>	<i>Name</i>					
	CCP 1 <i>(leave blank if not applicable)</i>						
	CCP 2 <i>(leave blank if not applicable)</i>						
	CCP 3 <i>(leave blank if not applicable)</i>						
<b>3.</b>	<b>LIQUIDITY PROFILE</b>						
	<b>Portfolio Liquidity Profile</b>						
<b>19</b>	<b>Investor Liquidity Profile</b>						
	Percentage of portfolio capable of being liquidated within:						
	1 day or less	2 - 7days	8 - 30 days	31 - 90 days	91 - 180 days	181 - 365 days	more than 365 days
<b>20</b>	<b>Value of unencumbered cash</b>						
	<b>Investor Liquidity Profile</b>						
<b>21</b>	<b>Investor Liquidity Profile</b>						
	Percentage of investor equity that can be redeemed within (as % of AIF's NAV)						
	1 day or less	2 - 7days	8 - 30 days	31 - 90 days	91 - 180 days	181 - 365 days	more than 365 days



<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED TO COMPETENT AUTHORITIES</b> (Article 24(2) of Directive 2011/61/EU)		
	<b>Data Type</b>	<b>Reported Data</b>
<b>22</b>	<b>Investor redemptions</b>	
	<b>a) Does the AIF provide investors with withdrawal / redemption rights in the ordinary course?</b>	Yes No
	<b>b) What is the frequency of investor redemptions (if multiple classes of shares or units, report for the largest share class by NAV)</b>	<i>[Select one]</i> Daily Weekly Fortnightly Monthly Quarterly Half-yearly Annual Other N/A
	<b>c) What is the notice period required by investors for redemptions in days (report asset weighted notice period if multiple classes or shares or units)</b>	
<b>23</b>	<b>Special arrangements and preferential treatment</b>	
	<b>a) As at the reporting date, what percentage of the AIFs NAV is subject to the following arrangements :</b>	% of NAV
	Side pockets	
	Gates	
	Suspension of dealing	
	Other arrangements for managing illiquid assets ( <i>please specify</i> )	[Type] [%]
	<b>b) Indicate the percentage of net asset value of AIF's assets that are currently subject to the special arrangements arising from their illiquid nature under Article 23 (4) (a) of the AIFMD including those in question 25(a)?</b> Special arrangements as a % of NAV	
	<b>c) Are there any investors who obtain preferential treatment or the right to preferential treatment (e.g. through a side letter) and therefore are subject to disclosure to the investors in the AIF in accordance with Article 23(1)(j) of the AIFMD?</b>	(Yes or no)
	<b>d) If 'yes' to letter c) then please indicate all relevant preferential treatment:</b>	
	Concerning different disclosure/reporting to investors	
	Concerning different investor liquidity terms	



<b>AIF-SPECIFIC INFORMATION TO BE PROVIDED TO COMPETENT AUTHORITIES</b> (Article 24(2) of Directive 2011/61/EU)		
	Data Type	Reported Data
<b>32</b>	<b>Historical risk profile</b>	
	<b>a) Gross Investment returns or IRR of the AIF over the reporting period (in %, gross of management and performance fees)</b>	
	1st Month of Reporting Period	
	2nd Month of Reporting Period	
	.	
	.	
	Last Month of Reporting Period	
	<b>b) Net Investment returns or IRR of the AIF over the reporting period (in %, net of management and performance fees)</b>	
	1st Month of Reporting Period	
	2nd Month of Reporting Period	
	.	
	.	
	Last Month of Reporting Period	
	<b>c) Change in Net Asset Value of the AIF over the reporting period (in %, including the impact of subscriptions and redemptions)</b>	
	1st Month of Reporting Period	
	2nd Month of Reporting Period	
	.	
	.	
	Last Month of Reporting Period	
	<b>d) Subscriptions over the reporting period</b>	
	1st Month of Reporting Period	
	2nd Month of Reporting Period	
	.	
	.	
	Last Month of Reporting Period	
	<b>e) Redemptions over the reported period</b>	
	1st Month of Reporting Period	
	2nd Month of Reporting Period	
	.	
	.	
	Last Month of Reporting Period	

Monetary values should be reported in the base currency of the AIF.

#### RESULTS OF STRESS TESTS

Please provide the **results of the stress tests** performed in accordance with point (b) of **Article 15(3) of Directive 2011/61/EU** [*risks associated with each investment position of the AIF and their overall effect on the AIF's portfolio can be properly identified, measured, managed and monitored on an on-going basis, including through the use of appropriate stress testing procedures;*] (free text)

Monetary values should be reported in the base currency of the AIF.

Please provide the **results of the stress tests** performed in accordance with the **second subparagraph of Article 16(1) of Directive 2011/61/EU**. [*AIFMs shall regularly conduct stress tests, under normal and exceptional liquidity conditions, which enable them to assess the liquidity risk of the AIFs and monitor the liquidity risk of the AIFs accordingly.*] (free text)

Monetary values should be reported in the base currency of the AIF.

<b>AIF-SPECIFIC INFORMATION TO BE MADE AVAILABLE TO THE COMPETENT AUTHORITIES</b>		
<b>(Article 24(4) of Directive 2011/61/EU)</b>		
	<b>Data Type</b>	<b>Reported Data</b>
<b>1</b>	<b>Of the amount of collateral and other credit support that the reporting AIF has posted to counterparties: what percentage has been re-hypothecated by counterparties?</b>	
<b>Borrowing and Exposure Risk</b>		
<b>2</b>	<b>Value of borrowings of cash or securities represented by:</b>	
	Unsecured cash borrowing:	
	Collateralised/secured cash borrowing — Via Prime Broker:	
	Collateralised/secured cash borrowing — Via (reverse) repo:	
	Collateralised/secured cash borrowing — Via Other:	
<b>3</b>	<b>Value of borrowing embedded in financial instruments</b>	
	Exchange-traded Derivatives: Gross Exposure less margin posted	
	OTC Derivatives: Gross Exposure less margin posted	
<b>4</b>	<b>Five largest sources of borrowed cash or securities (short positions):</b>	
	Largest:	
	2 <sup>nd</sup> largest:	
	3 <sup>rd</sup> largest:	
	4 <sup>th</sup> largest:	
	5 <sup>th</sup> largest:	
<b>5</b>	<b>Value of securities borrowed for short positions</b>	
<b>6</b>	<b>Gross exposure of financial and, as the case may be, or legal structures controlled by the AIF as defined in Recital 78 of the AIFMD</b>	
	<i>Financial and, as the case may be, or legal structure</i>	
	<i>Financial and, as the case may be, or legal structure</i>	
	<i>Financial and, as the case may be, or legal structure</i>	
	...	
<b>7</b>	<b>Leverage of the AIF:</b>	
	<b>a) Gross Method</b>	
	<b>b) Commitment Method</b>	

Monetary values should be reported in the base currency of the AIF.