

Link'n Learn

AIFMD Implementation

AIFM structuring and delegation,
valuation and remuneration

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Leading business advisors

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Presenters



Niamh Geraghty
Director – Investment Management Advisory
Deloitte & Touche Ireland
ngeraghty@deloitte.ie
+1 353 1 417 2649



Helen Beck
Partner – Financial Services Remuneration
Deloitte UK
hebeck@deloitte.co.uk
+44 (0)20 7007 8055



John Cotton
Director – Financial Services Remuneration
Deloitte UK
jdcotton@deloitte.co.uk
+44 (0)20 7007 2345



Patrick Rooney
Manager - Investment Management Advisory
Deloitte & Touche Ireland
prooney@deloitte.ie
+1 353 1 417 2962

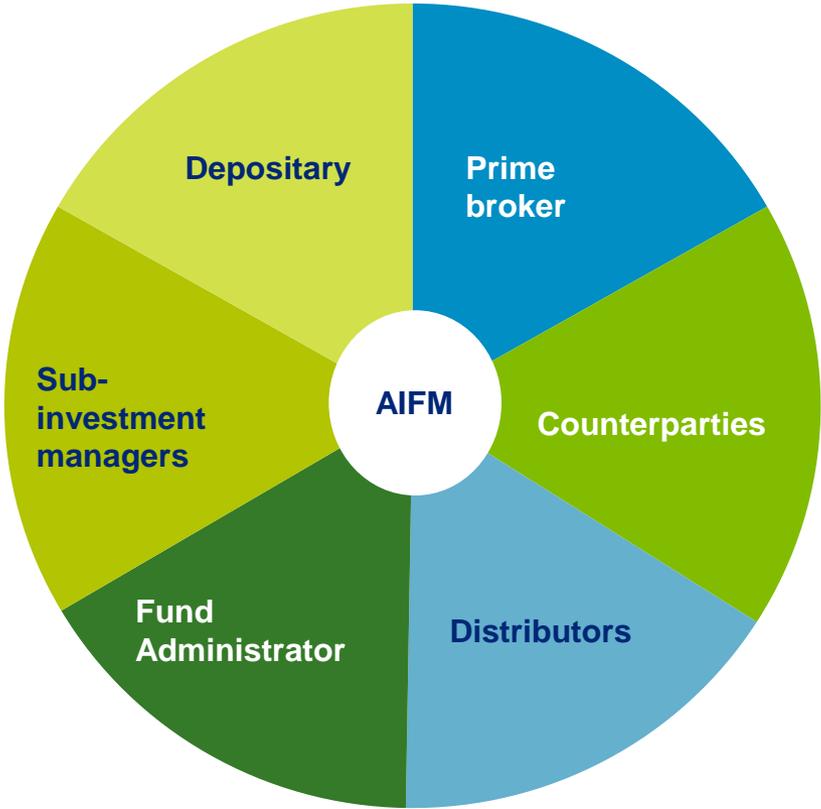
AIFM structuring and delegation

AIFM responsibilities

Key compliance areas



Industry participants



AIFM key responsibilities



AIFM governing body / senior management assumes responsibility for various areas:

- Implementation of the general investment policy
- Overseeing the approval of the investment strategies
- Establishing and implementing the valuation policies and procedures
- Ensuring an effective compliance function
- Approving and reviewing the risk management policy
- Approving and reviewing internal decision-making procedures
- Establishing and applying a compliant remuneration policy
- Addressing any deficiencies

Appointment and authorisation of an AIFM

- Different entities could be appointed as the AIFM:
 - Investment manager
 - Management company
 - The fund in the case of a self-managed structure
- A number of factors will need to be considered in determining which type of AIFM is most suitable and there is no “one size fits all”

Letter-box criteria

MiFID restrictions

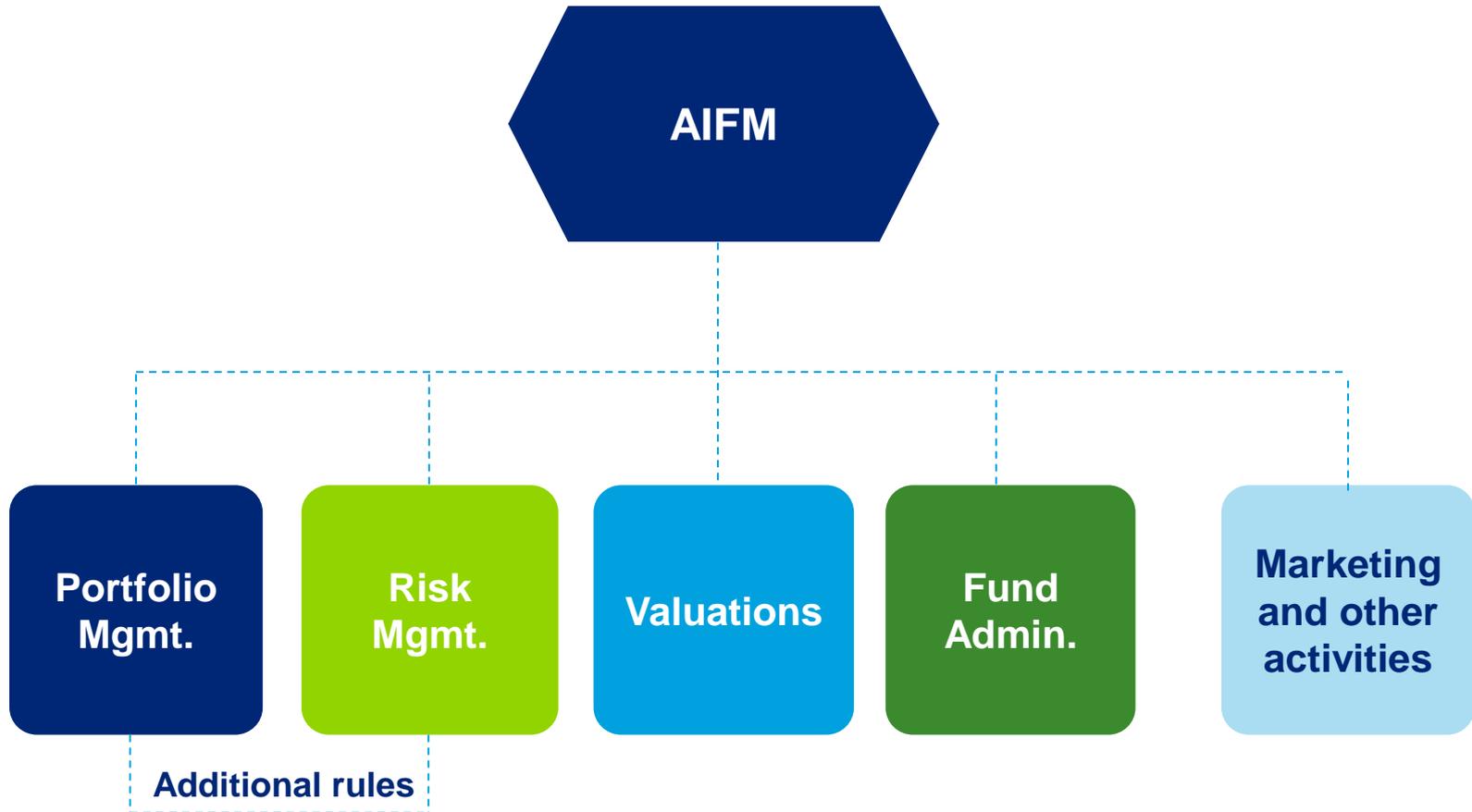
Business model

Entity consolidation

Tax implications

Cost

Delegation possibilities



Delegation control framework

Objective reason

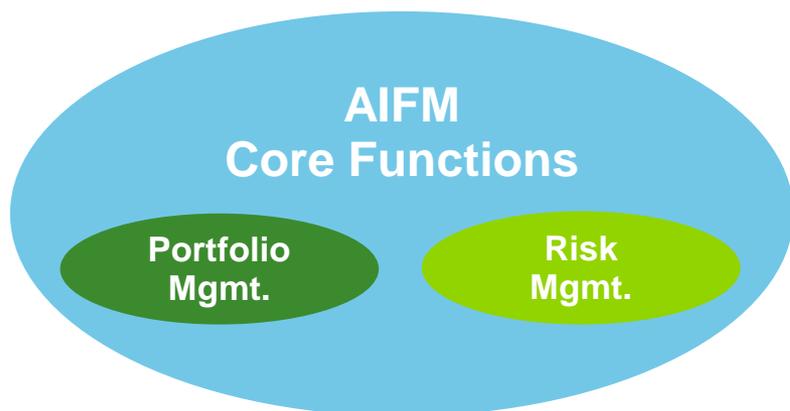
Written agreement

Expertise & resources

Conflicts of interest

Supervision

Delegation – Letter-box entity criteria



AIFM has to perform functions relating to **either** PM or RM and must be “closely involved in the decision making of its delegates”

- Delegation of the core and other investment management (IM) functions is possible
- But an AIFM may not delegate IM functions to the extent that it becomes a “**letter-box entity**”
- IM functions cannot be delegated “to an extent that **exceeds by a substantial margin** the investment management functions performed by the AIFM itself”

Key factors to determine if AIFM is a letter-box entity

- Does not have the necessary resources and expertise to supervise delegates 
- Loss of contractual rights over delegates 
- Cannot mitigate risks of delegation 
- Balance of investment management (portfolio management & risk management) functions delegated compared to those performed by the AIFM 

Delegation – Letter-box entity criteria

The Commission's final Letter-box entity criteria have moved away from a solely quantitative approach to a more nuanced qualitative approach

National regulators are charged with making an assessment of the delegation structure based on qualitative criteria such as:

- the types of assets the AIF or the AIFM
- the importance of the assets under delegation for the achievement of investment goals
- the geographical and sectoral spread of the AIF's investments
- the risk profile of the AIF
- the type of investment strategies pursued
- the **types of tasks** delegated in relation to those retained
- Whether the delegates are within the **same corporate group**

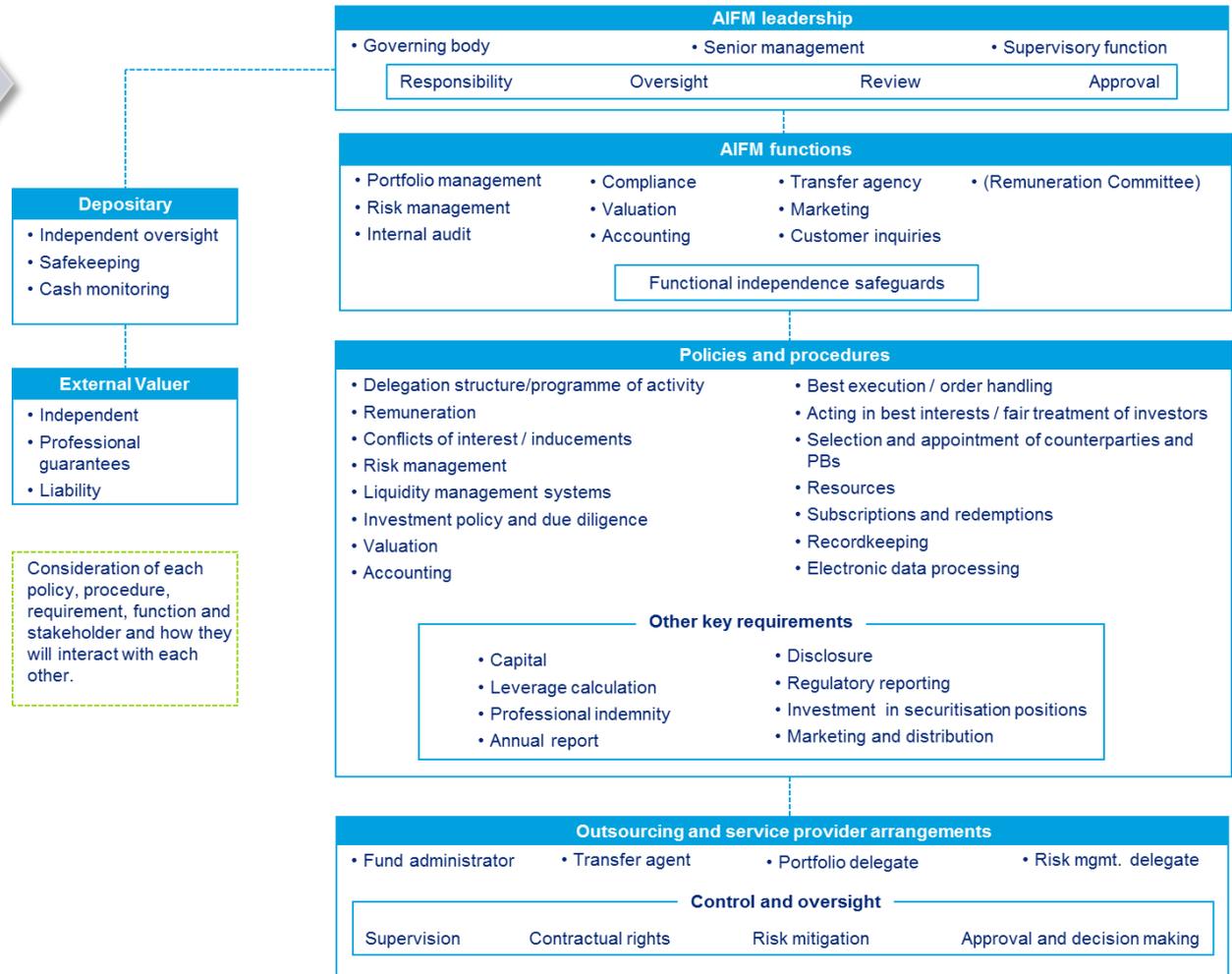


The Commission is to review the application of the rules after 2 year and may specify further measures. ESMA may issue delegation guidelines.

AIFM mapping

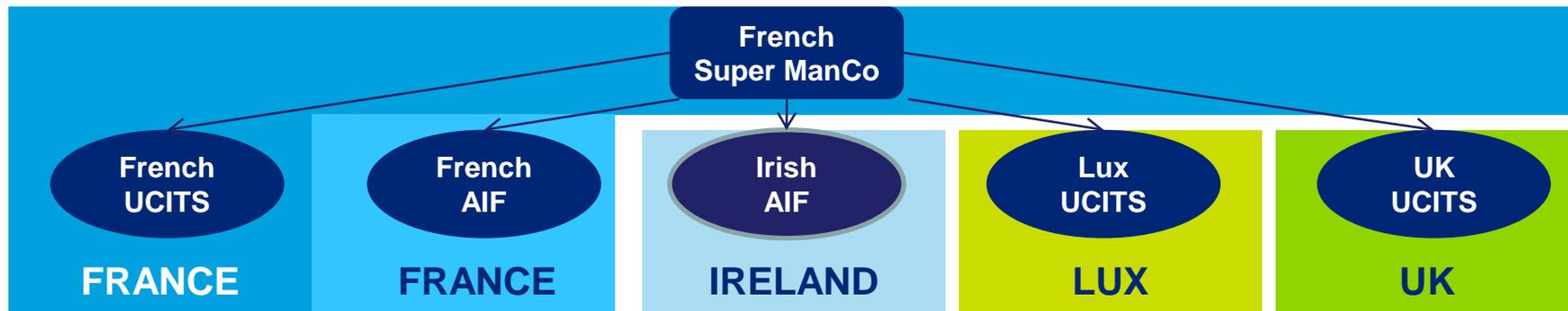
Developing your target operating model

1. Project plan
2. Allocation of AIFM responsibilities
3. Develop detailed policies, procedures and processes
4. "Programme of activity"



AIFM structuring

Universal or “Super” ManCo



- AIFM Management Company Passport
- Existing UCITS management companies reflect the AIFMD model
- AIFMs / AIFs can be structured to leverage off existing UCITS management companies
- A UCITS ManCo could apply to be the AIFM
- Tax issues

Delegation

Ireland

- At least 2 Irish resident directors
- 16 management functions must be carried out by the AIFM
- Nominate “designated persons” to monitor and control each activity
- Designated persons are subject to fitness and probity pre-approval
- Focus on reporting and documentation

Luxembourg

- At least 2 “Conducting Officers” located in Luxembourg
- Both portfolio and risk management could be delegated but not in whole at the same time
- Conducting Officers are subject to CSSF approval
- “Management information” must be held in Luxembourg
- Focus on reporting and documentation

Board membership – sufficient skill and expertise

Focus on qualitative activities

Document decisions

Control, oversight and reporting

Remuneration

Summary of remuneration requirements

AIFMD	UCITS V	CRD IV
<ul style="list-style-type: none">• Appropriate balance between fixed and variable pay• At least 50% of variable remuneration should consist of units or shares of the AIF (or equivalent)• At least 40% to 60% of variable remuneration should be deferred over a minimum period of 3 to 5 years• Variable remuneration should be subject to malus/clawback• Must establish a Remuneration Committee made up entirely of non-executives• Must disclose aggregate remuneration in fund annual report	<ul style="list-style-type: none">• Contains all the remuneration requirements as under AIFMD• In addition, introduces a 1:1 cap on variable remuneration as a proportion of fixed remuneration. Currently there is no provision for this to be increased to 2:1, although this may change in line with CRD IV• Remuneration Committees should include employee representatives• Requirement for a deferral of at least 25% of variable pay over at least three to five years in units (not 40% as under AIFMD)• Latest vote in the European Parliament delayed until early July 2013	<ul style="list-style-type: none">• Carries forward existing provisions of CRD III relating to remuneration• In addition, introduces a cap limiting the ratio of the variable component of remuneration to the fixed component to 1:1.• Can be increased to 2:1 with shareholder approval• Applies to Code Staff only. Recent EBA guidelines have widened the definition of Identified Staff/Code Staff such that more individuals will be affected• Extends to overseas staff of EU entities, as well as to staff of overseas entities based in the EU

Remuneration

Identified Staff

- Specific rules apply to “Identified Staff” of the AIFM (similar to Code Staff under CRD). This should include the following categories of staff, unless it can be demonstrated that they have no material impact on the risk profile of the AIFM or the AIFs under management:

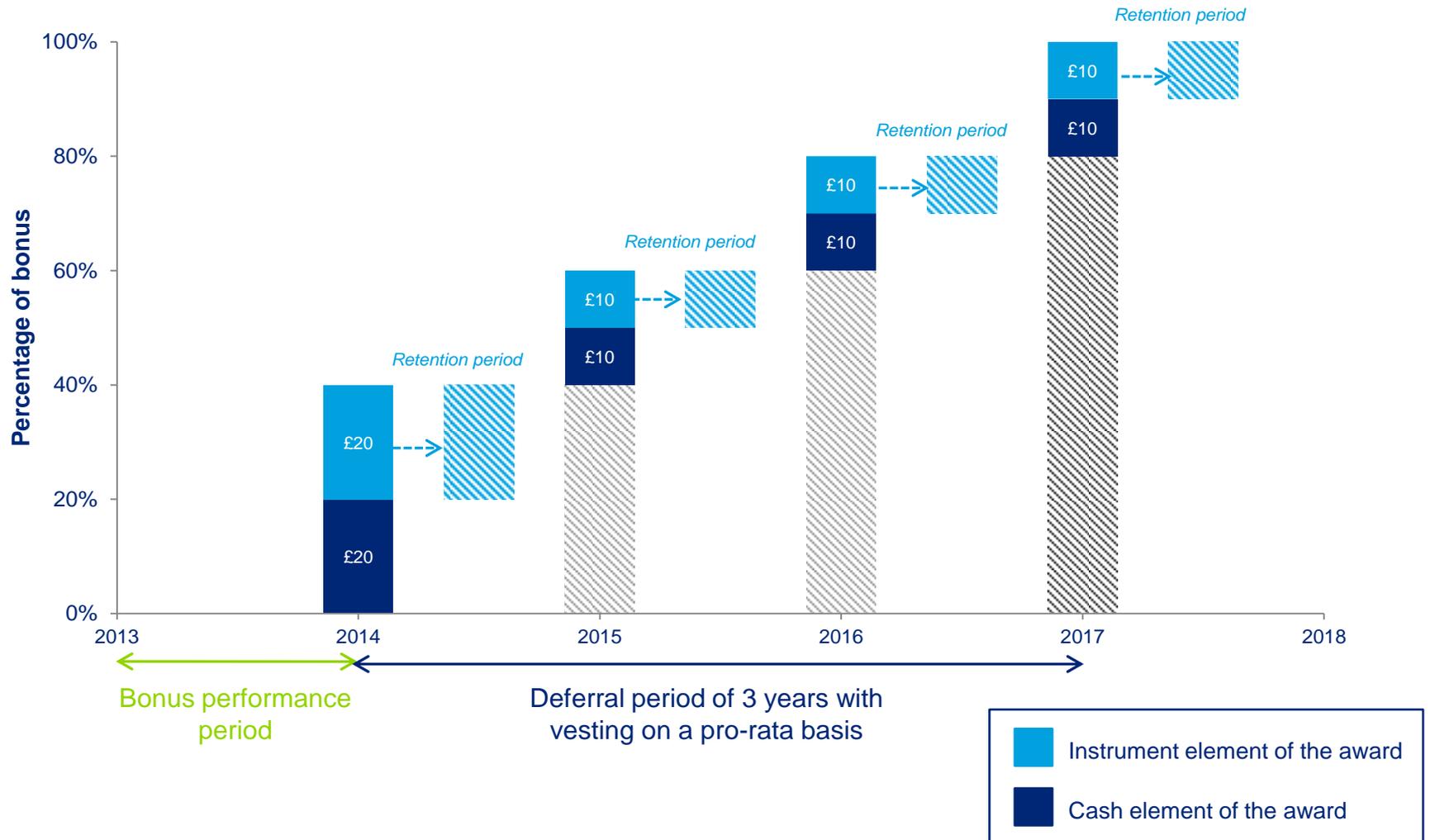


- Both executive and non-executive members of the governing body of the AIFM are Identified Staff.
- Staff with an administrative/functional support role are not automatically within the scope of Identified Staff. However, staff heading these functions should be.
- Partners in LLPs and employees who own common equity of an AIFM whose professional activities have a material impact on the risk profile of the AIFM or an AIF that the AIFM manages, will also be expected to be Identified Staff.
- Also - categories of staff of the entities to which portfolio management or risk management activities have been delegated by the AIFM, whose professional activities have a material impact on the AIF under management.

Remuneration

Illustration of deferral requirements

Example assumes variable remuneration is £100 with 60% deferred pro-rata over 3 years



Remuneration

Market responses

Deferred remuneration

- **AIFMD/UCITS** – various considerations
 - What instruments are appropriate and how can they be delivered? What should the ratio be?
 - Length of deferral period/retention period?
 - In what circumstances might “malus” and “clawback” apply?
- **CRD IV** – possible to use bail-in instruments/CoCos?

Proportionality

- **CRD IV** – will proportionality apply to fixed/variable pay ratio cap?
- **AIFMD** – proportionality guidance from FCA?
 - Which AIFMD requirements can be dis-applied?
 - Will a Remuneration Committee be needed?
 - Will there be a tiered system?
- **UCITS V** – too early to say

Governance

- How are Identified Staff determined?
 - **CRD** – EBA to provide further guidelines
 - **AIFMD** – ESMA guidelines issued; further local guidance?
- **AIFMD/UCITS** - Are non-executive directors needed?
- How do the various rules apply to entities which are part of a group?

Interaction between regulations

- Will asset management firms in scope of CRD IV be able to apply proportionality to the bonus cap?
- Will the bonus cap remain in UCITS V and be extended to AIFMD?
- When multiple directives apply, which takes precedence?

Valuation

AIFMD – Valuation

1

Set out the pricing methodology
(different methodologies allowed for different funds)

2

Establish written policies and procedures
(Detailed explanation of valuation policies and procedures)

3

Determine valuation frequency
(according to trading frequency or at least annually)

4

Allocate valuation role internally or externally
(Independence safeguards, professional guarantees)

AIFMD – Valuation

Who can perform the valuation?

- Valuation independence whether external or internal
- AIFM retains responsibility for proper valuation and the calculation of the NAV. The AIFM's liability is not affected by the appointment of an external valuer.

Internal valuation

- An AIFM can perform the valuation task if functionally separated from the portfolio management and the remuneration policy and other conflicts of interests are managed internally
- If performed in-house, a Member State can ask for AIFM valuation procedure reviews either by an external valuer or auditor.

External valuer

- Subject to mandatory professional registration, rules on professional conduct.
- Must have professional indemnity insurance for any losses suffered by the AIFM, AIF or AIF investors.
- Third party fund administrator calculating NAV only may not be the “external valuer”

Key valuation controls

- Independent valuation model validation
- Valuation methodologies should be applied consistently across AIF
- Policies and procedures
- Additional controls around complex and illiquid asset valuation

Frequency of valuation

- For open-ended AIFs: on a frequency appropriate for assets and fund issuance/redemption
- For closed-ended AIFs: align with AIF capital increase/decrease
- NAV per share must be calculated at least once per year

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