AIFMD reporting survey
What lies ahead, what went before

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In response to the last financial crisis, there has been a global regulatory drive for greater financial transparency, and reporting schemes such as those under the European Market Infrastructure Regulation (EMIR), Markets in Financial Instruments Regulation (MiFIR), Packaged Retail and Insurance-based Investment Products (PRIIPS), Solvency II, and the Alternative Investment Fund Managers Directive (AIFMD) were put in place with this in mind.

The first round of AIFMD reporting is now behind us, providing a good opportunity to take a step back and consolidate our findings and experiences of the process. Certainly, there is still much ongoing discussion concerning the use and nature of the data collected, but while this debate continues, the survey results from this first round give a preliminary understanding of the reporting process and allow for the development of a more strategic approach for future iterations.

Whether the future reporting requirements of AIFMD will remain the same or not is uncertain and depends on the evaluation of regulatory authorities as well as on the maintenance of an ongoing dialogue between fund managers and regulators.

What is more certain is that the production landscape certainly warrants change, as our recent survey suggests.

In addition to these immediate conclusions, in a broader AIFMD perspective, the survey results also give indications of how important the distribution of non-EU products remains for asset managers and of the level of challenge they will potentially have to face once the European Securities and Markets Authority (ESMA) decides on the future direction of the AIFMD passport for non-European managers and funds.

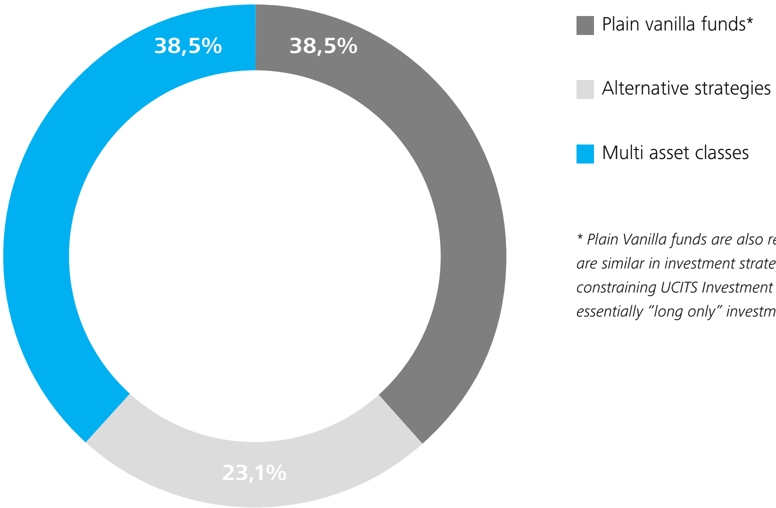
The AIFMD reporting survey

Survey participants

The survey was sent out to over 150 registered/authorized alternative investment fund managers (AIFMs), with the majority located in Luxembourg and the rest located in the UK, France, Ireland and Belgium. Nearly two-thirds of all respondents qualified as “Universal ManCos,” also referred to as “Super ManCos,” which hold both a UCITS and AIFM license.

One-third of participants qualified as registered or authorized AIFMs and a small remaining portion fell under the all-encompassing category of “other” alternative investment fund managers. Of the funds captured by the AIFMD, less than 25 percent followed pure alternative strategies. The majority were split equally between plain vanilla funds and multi asset classes. One of the main criticisms of the AIFMD is precisely that it may be too comprehensive, capturing all alternative investment funds (AIFs) irrespective of asset class or strategy, provided the fund is not a UCITS.

Figure 1: Main strategy of AIFs managed



** Plain Vanilla funds are also referred to in the document as UCITS “look-alikes”. They are funds that are similar in investment strategy and most respects to UCITS funds but are not subject to the more constraining UCITS Investment Restriction rules. They are the former Part II funds, and SIFs that follow essentially “long only” investment strategies in recognised UCITS-like asset classes and sectors.*

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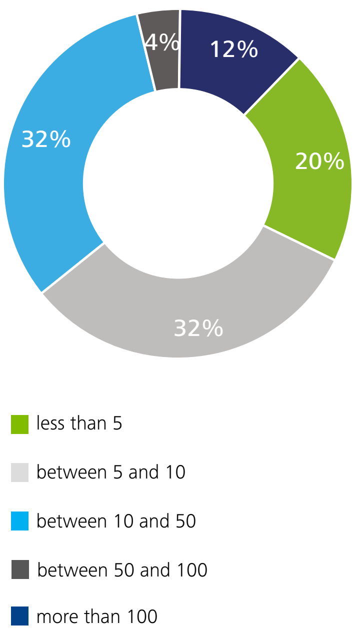
Impact of fund volumes

More than half of the surveyed AIFMs had more than €1 billion in assets under management at the time of reporting, and two-thirds were managing between 5 and 50 AIFs that required reporting. However, when splitting the analysis on AIFs to report on Super ManCos and authorized AIFMs, we see that statistics are skewed slightly differently between the two types of investment managers.

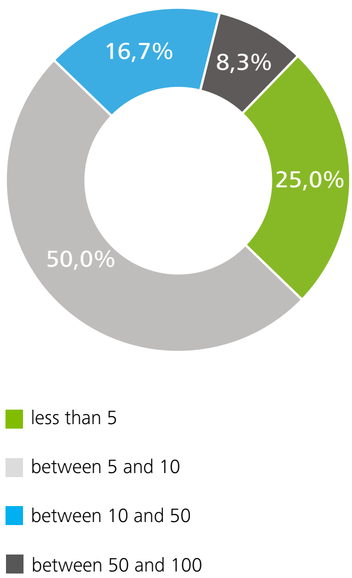
One-third of Super ManCos had between 5 and 10 funds to report on and another third had between 10 and 50. It is also worth noting that one-fifth had less than 5 funds to report and just over one-sixth of all Super ManCos that had more than 50 funds to report on. At the same time, a quarter of the surveyed authorized AIFs had less than 5 funds to report on and half had between 5 and 10. Of the remaining quarter, two-thirds had between 10 and 50 funds to report on, and only one third had between 50 and 100.

Figure 2:

Super ManCo: AIFs to report



Authorised AIFMs: AIFs to report



Reporting took its greatest toll in terms of cost effectiveness on the intermediate market segment that had between 5 and 50 funds on which to report. This effect was magnified by the requirement to report at the AIFM level rather than fund by fund.
At the low-volume end of the spectrum (i.e., managers with single digit fund numbers to report on), ad hoc quasi-manual reporting solutions proved to be the most cost effective. It is, however, difficult to stretch and apply this approach to AIFMs with intermediate fund volumes since it calls for the immediate availability of skilled resources and compromises opportunity costs that are implied by devoting these resources to AIFMD reporting instead of other tasks. The survey also reflected the fact that there was a relatively low correlation between the number of alternative funds of a given manager and its total assets under management, unsurprising in itself for certain asset classes, but a statistical challenge when focus shifts to interpretation.

This can also in part be explained by the diverse nature of the funds for which AIFMD requires reporting but nevertheless still raises the question of how regulatory analysis will interpret the parameters that are at the root of the variances in the reported data.

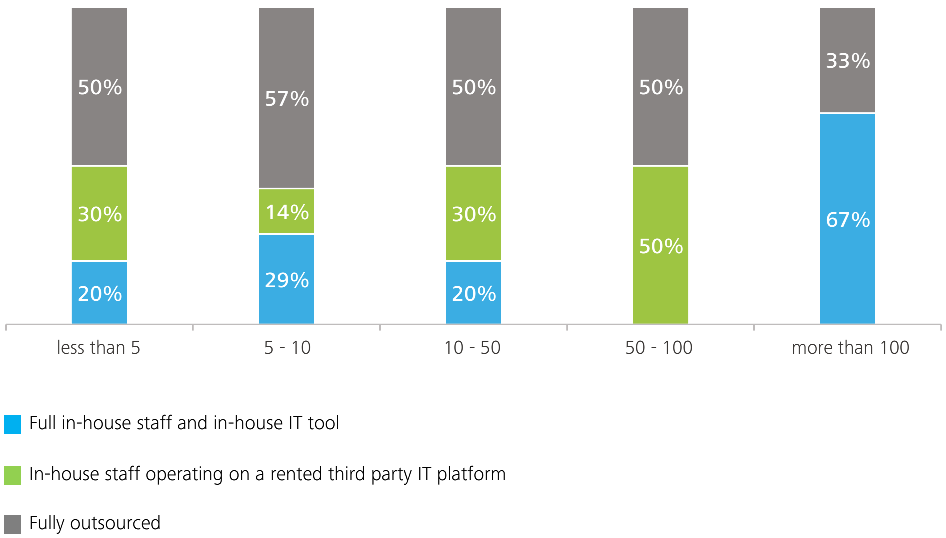
Reporting solutions

Three different approaches were taken to reporting. Some asset managers decided to outsource the project entirely, others decided to complete it 100 percent in-house, and a third group decided to complete it in-house using third-party technology.

As Figure 3 shows, the adopted strategy varied somewhat depending on the number of AIFs to report on. Asset managers with more than 100 funds on which to report preferred to either fully outsource or fully develop an in-house solution, the ratio being 1:2 in opting for this choice.

For asset managers with less than 100 funds to manage, more than 50 percent preferred to go with outsourcing whereas only barely one-fifth opted for a full in-house solution. Interesting to note as well is that nearly half of the managers with 50-100 funds to report on chose to go with in-house solutions that used third-party technology.

Figure 3: Comparison of solution chosen depending on number of AIFs to report



Having said this, our survey results also show that the experience of producing the reports was judged to have been far more difficult than anticipated, with 63 percent of asset managers backing this opinion. Taking the two together, we would seem to have seen either significant padding of budgets for contingency or significant under-estimation of internal costs.

In all probability, this suggests that the full costs in terms of time commitment and internal resource allocation have not been fully taken into account.

Four years ago when AIFMD was conjured up by the European Commission, Deloitte carried out a preliminary survey on the directive. One of the questions in this survey asked asset managers who was going to cover the implicit costs. 58 percent of AIFMs replied that they would be responsible for covering costs. However, when asked the same question this time round, only 42 percent of AIFMs replied that they will be covering the full extent of the costs, and another 25 percent believe the costs will be shared between the AIFMs and the AIFs.

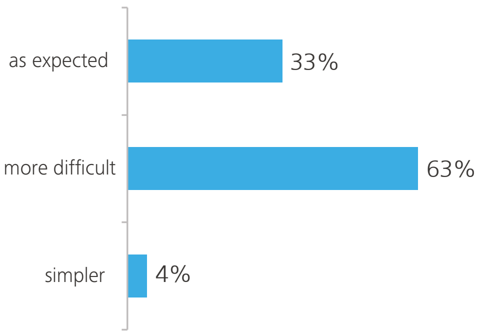
The costs

Overview

When it comes to estimating total costs for AIFMD reporting, the exercise is less straightforward than a simple assessment of the overt and billable costs. Indeed, the reporting also contains hidden internal costs such as the cost of staff engaged on the activity and the opportunity cost for allocating qualified staff like this the AIMFD reporting task instead of other activities.

Nonetheless, according to our survey results, the cost appraisals that had been carried out prior to reporting proved to be spot on since the majority of asset managers disclosed that reporting costs had fallen within the estimated ball park.

Figure 4: How was the experience of producing AIFMD reports?



Resource allocation costs

The greatest portion of total costs were due to staff allocation and the time spent reporting, with a clear correlation between the amount of staff assigned to work on the reporting and the number of funds to be reported on by the manager.

Figure 5 clearly shows that there are two extremes to this scenario, where, depending on the number of AIFs, either very low levels or very high levels of staff were assigned to the reporting task. These staff distributions are similar to those that were assigned to the reporting task on a recurring basis. When comparing this distribution to that in Figure 3, we can suggest that the managers managing between 5 and 50 AIFs and using a partial or full in-house solution were likely to be those that were forced to engage a higher task force.

A further note on the resource allocation costs should be made concerning the departments engaged in reporting.

As Figure 6 shows, one-third of those engaged in-house were from operations and more than one-third worked in risk. The future availability of skilled risk professionals will be scarce. Operational in-house taskforces are declining more and more due to the time and cost benefits of outsourcing. Risk professionals on the other hand will continue to be heavily required due to the key role of risk in market assessments. However, there is a definite shortage in available risk professionals, which makes their allocation to reporting tasks a waste of the skills at hand.

Time costs and unexpected gains

Time is an important cost variable, if not the most important one, and depending on how early or late reporting activities for AIFMD began, engaged headcount was either relatively moderate or very high. Some houses and outsourcers were the first to move, launching their first drafts as soon as the first reporting template was issued and giving themselves more time to prepare improved iterations of their reports. It was definitely these in-house players and outsourcers that had taken early initiative who lightened the load for the rest that followed. Indeed, much of the reporting knowledge and experience gained by the early movers was shared in a collaborative environment among AIFMs and thereby largely reduced the duration of the reporting cycle for many.

Early moving industry majors and service providers were involved in the reporting process for up to 24 months. However, nearly two-thirds of survey respondents admitted they only spent 6-12 months on the project and another third only spent 3-6 months. These significant gains in time may not be available with future reporting cycles once the market settles down to a business as usual production mode.

Figure 5: Number of staff working on the implementation project, depending on number of AIFs to report

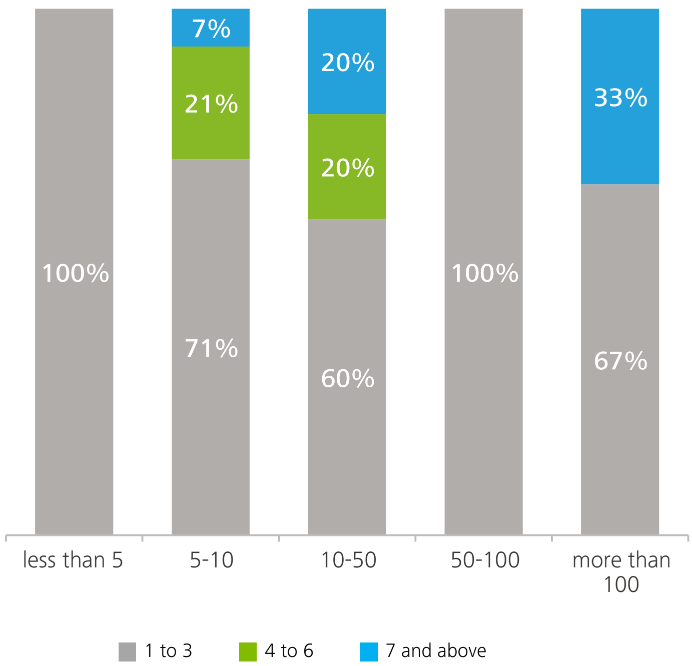
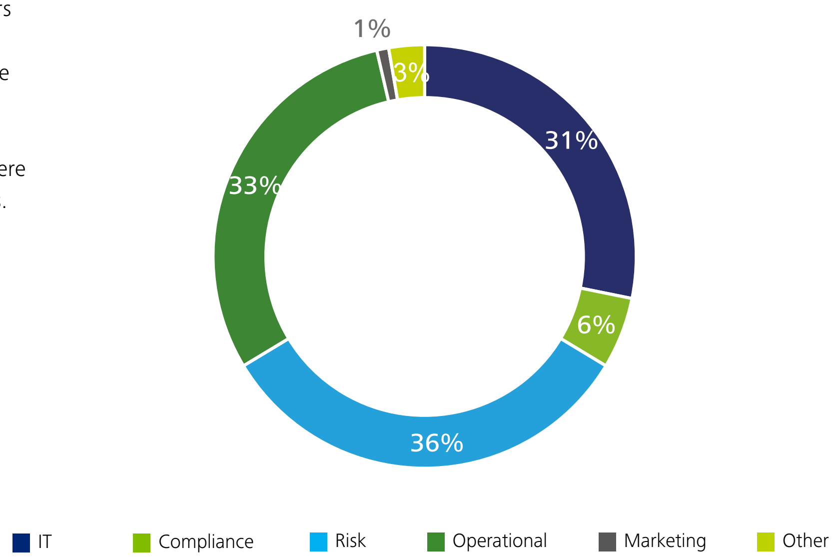


Figure 6: Departments involved in the AIFMD Reporting



What additional hurdles were faced in the first round of AIFMD?

There are a few points that came to everyone's attention either at the last minute or once reports were submitted. In essence, they constitute minor bumps in the process of first-round reporting attempts, and we hope to see them smoothed out in future. Some of these included ambiguities in reporting requirements, such as a general misunderstanding concerning the correct definition of the term "optional," which we now understand to mean "if relevant" and not "if you would like to include"!

Other more technical difficulties included the actual delivery of the data. Some regulators were not ready to receive the reports when the deadline was up, and, in other cases, there were complications for AIFMs that had to report in several jurisdictions. Indeed, although reporting templates were standardized throughout Europe (except for the UK where the FCA decided to use the first template provided by the ESMA instead of the second), validation protocols were not standardized—a situation that unfortunately caused some turmoil in several jurisdictions.

What does the future of AIFMD reporting hold?

Survey results clearly point out that the most cost-effective solution will depend on the scale to report on, and asset managers need to evaluate whether or not the choice of meeting the burden with internal resources and time is a beneficial one.

Future reporting cycles may or may not be as quick depending on the interest in going forward collectively and sharing reporting insights, and the degree of change management—either in the reporting itself or with the introduction of new product. Either way, a transversal approach to the required data management is necessary since AIFMD is not a regulatory initiative that stands in isolation. The most cost-efficient solution is surely to consolidate reporting efforts with the ongoing EMIR, MIFIR, KIID, PRIIPS, and Solvency II, which rely on the same or similar data sources. Certain general conclusions emerge from the work we have done that also point the way for the future. There is still a need for improvement in the data acquisition processes to get the required data to the relevant regulator and on to ESMA. There is a need for transparency as to what the recipient regulators and ESMA intend to do with the data. Some of the data sets may need revision to ensure that they are relevant and to avoid contaminating data sets with irrelevant information from different asset classes.

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Another very interesting conclusion to draw is that many AIFMs are not backing off from the distribution of non-EU products, notwithstanding the increase in reporting and compliance complexity. Indeed, the sample reports on a relatively high number of non-EU funds, especially for Luxembourg and the UK. This falls in line with a general opinion among asset managers concerning the potential extension of the passport to non-European entities that predicts that the passport will be more easily attainable for EU AIFMs with non-EU products than for solely non-EU structures, and we still have a way to go before we can anticipate the replacement of private placements with the passport. For many asset managers national placement regimes are working. This will add renewed energy to those calling for a continuance of the two regimes in parallel.

When asked whether they would consider outsourcing as a feasible solution in the future, 72 percent of the asset managers that replied answered "yes." Between this general statement, however, and a move to outsource a number of impediments were noted and raised. Indeed, when questioned on their hesitation to outsource, many managers responded with a reluctance to separate production from responsibility at this stage of AIFMD maturity. Undeniably, ultimate liability will remain with the AIFM, but, nonetheless, there is an abundance of examples where the separation of task execution and responsibility was carried out successfully in the past; there is no reason why AIFMD reporting should be an exception. Debate remains open on whether or not the AIFMD reporting template will change, both in scope and content. This debate, of course, contributes to a certain atmosphere of apprehension with regard to future alterations to the reporting agenda and format. Thus, a more widespread sense of reporting stability may be the green light asset managers are waiting for before they decide to trim down their costs and alleviate themselves of the burden of regulatory reporting.

To the point

- Each entity encountered and resolved its own raft of issues—outsource providers encountered and resolved all of them. As the second cycle kicks in, as definitions, transmission protocols, and interpretations evolve and change, the outsource providers by definition must stay on top of them. The success of the first cycle was the result of a large degree of mutualization. A similar level of mutualization going forward will only be available in full through the outsource option
- There is the significant reporting activity on behalf of funds distributed under NPRs (National Placement Regimes), possibly a real surprise in terms of volume and the take up of this distribution option
- There are the complex cost/efficiency dynamics as they apply to a "sector" as diverse as AIFs. It has been said that many times that one size does not fit all, and yet we have a reporting universe that spans the spectrum from low volume, high AUM closed-ended funds to high volume, open-ended algorithmically traded funds. Each has its own dynamics and requirements. More work now needs to be done on finding a lasting cost-effective solution for the outliers to the reporting process
- AIFMD reporting is a huge step into a world in which transparency is an ever more pressing requirement. Just recently, the SEC announced its upcoming Investment Company Reporting Rules within the context of the ongoing market reforms following on from the Dodd-Frank Act. Never has there been a time when flexible, accurate, appropriate, and timely reporting was more important in the pursuit of success in international fund markets