

III

(Preparatory acts)

EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 24 May 2012

on a draft Commission delegated regulation 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

(CON/2012/42)

(2013/C 47/01)

Introduction and legal basis

On 18 April 2012, the European Central Bank (ECB) received a request from the Commission for an opinion on a draft Commission delegated regulation 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 (hereinafter the 'draft delegated regulation').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union since the draft delegated regulation contains provisions affecting the European System of Central Banks' contribution to the smooth conduct of policies relating to the stability of the financial system, as referred to in Article 127(5) of the Treaty. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

Specific observations**1. Leverage**

- 1.1. The ECB has previously stated that the concept of leverage, as referred to in Directive 2011/61/EU ⁽¹⁾, is fundamental to the business model implemented by many alternative investment fund managers (AIFMs) ⁽²⁾. In general, the ECB agrees with the European Securities and Market Authority (ESMA) that information on the level of leverage calculated on the basis of gross exposure is key for the monitoring of systemic risk and that this information should also be provided to investors. While excessive leverage can create significant risks for financial stability, leverage risk is not the only risk for alternative investment funds (AIFs). Therefore, any information about leverage should be supplemented by relevant information about other risk sources. In this context, it is important that requirements aimed at addressing the various sources of risk are kept separate. Such sources of risk include the position risk, i.e. the market and credit risk relating to particular investments, and the leverage of AIFs.

⁽¹⁾ 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 (OJ L 174, 1.7.2011, p. 1).

⁽²⁾ ECB Opinion CON/2009/81 of 16 October 2009 on a proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/.../EC (OJ C 272, 13.11.2009, p. 1). All ECB opinions are published on the ECB's website at <http://www.ecb.europa.eu>

- 1.2. In order to be consistent and to prevent any regulatory arbitrage, the ECB finds it appropriate that the methods for calculation of leverage to be adopted should, to the extent possible, be consistent with the Basel III framework ⁽¹⁾ and the proposal for a directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms ⁽²⁾ and the proposed regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms ⁽³⁾ (hereinafter together the 'proposed CRD IV') ⁽⁴⁾. For example, this consistency should be ensured by reference to the recognition of hedging transactions and the treatment of cash borrowings. Moreover, cross-reference to the concepts laid down in the proposed CRD IV could also be considered ⁽⁵⁾.
- 1.3. As stated in paragraph 1.1 above, the ECB is of the view that, when calculating exposures, one should distinguish between: (a) the inherent risks of the assets (portfolios) being purchased by AIFs, i.e. 'position risk'; and (b) the actual leverage involved. Hence the two risk sources should be kept separate when determining the leverage of AIFs. For example, while cash borrowings from external sources that are not invested are indeed neither exposed to market risk nor credit risk, they increase the actual leverage of the AIF. By contrast, the proposed CRD IV does not seem to differentiate between different types of cash borrowings ⁽⁶⁾.
- 1.4. The draft delegated regulation refers to the application of the gross method and the commitment method ⁽⁷⁾. It does not include the advanced method ⁽⁸⁾ as this method would not ensure comparability of results. The ECB understands that the advanced method, which relaxes the rules of the commitment method, was designed for AIFMs managing AIFs, for which the commitment method may not be appropriate or may not provide meaningful results. The ECB supports the Commission's Decision not to include the advanced method since the application of the gross method and of the commitment method are sufficient and will provide useful information to both investors and competent supervisory authorities about the leverage of AIFs.

2. Risk management

The draft delegated regulation requires AIFMs to separate their risk management function from their operational function and suggests that this will be achieved when an exhaustive list of contingent conditions is fulfilled by the AIFM ⁽⁹⁾. If these conditions are not satisfied, safeguards shall be applied by the AIFM's governing body to mitigate the conflicts of interest that may pose a risk to the independent performance of risk management activities ⁽¹⁰⁾. In this respect, the ECB supports the separation of risk management from operational and management functions. The Commission may consider mandating ESMA to prepare general guidelines setting out objective criteria in order to avoid an inconsistent application across the Union and to monitor their implementation.

⁽¹⁾ See 'Basel III: A global regulatory framework for more resilient banks and banking systems', Basel Committee on Banking Supervision, December 2010, revised version June 2011.

⁽²⁾ Also amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate. COM(2011) 453 final.

⁽³⁾ COM(2011) 452 final.

⁽⁴⁾ A harmonised definition of leverage would not imply the harmonised calibration of the leverage ratio for credit institutions and AIFs.

⁽⁵⁾ See the definition of leverage provided by Article 4(86) of the proposed regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, COM(2011) 452 final.

⁽⁶⁾ Under the proposed CRD IV, all cash borrowings are recorded on-balance sheet and therefore increase leverage under this framework, regardless of subsequent use of the funds received. Exposure value of on-balance sheet items generally equals their accounting value remaining after specific valuation adjustments, e.g. for credit risk, have been applied; see Article 416(5) in conjunction with Article 106(1) of the proposed regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, COM(2011) 452 final.

⁽⁷⁾ Chapter II, Section 2, Articles 9 and 10, of the draft delegated regulation.

⁽⁸⁾ See ESMA's technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive, 16 November 2011 (hereinafter 'ESMA's Advice'), ESMA/2011/379, p. 459.

⁽⁹⁾ Article 43 of the draft delegated regulation.

⁽¹⁰⁾ Article 44 of the draft delegated regulation.

3. *Investment in securitisation positions*

- 3.1. The draft delegated regulation ⁽¹⁾ provides that AIFMs may invest in securitisation positions provided that they conduct a thorough due diligence of the sponsor and originator. More specifically, the draft delegated regulation provides that, before investing in securitised instruments, the AIFM should: (a) satisfy certain qualitative requirements, e.g. a comprehensive understanding of the risk profile of the investments and appropriate formal policies and procedures ⁽²⁾; and (b) ensure that sponsors, as well as originators, satisfy a number of qualitative requirements including effective risk management requirements, adequate diversification strategies, etc. ⁽³⁾.
- 3.2. The ECB supports the qualitative criteria that foster the AIFMs' awareness of the risks taken prior to investing in securitised products. As regards the provisions under 3.1(b) above, the obligations on AIFMs to ensure that originators and sponsors have proper risk management procedures may be difficult to apply as AIFMs may not be able to directly check criteria pertaining to the internal procedures of the sponsor or originator.
- 3.3. In order to ensure that such requirements do not restrict AIFMs from investing in securitised products, thereby hindering the broader goal of reviving the securitisation market, the draft delegated regulation may provide that ESMA shall give general guidance on the precise documentation to be provided by sponsors or originators to AIFMs regarding the above qualitative requirements.

4. *Depositary functions*

- 4.1. The ECB welcomes the comprehensive duties that depositaries will fulfil ⁽⁴⁾ pursuant to the draft delegated regulation. In particular, the ECB believes that the detailed requirements ⁽⁵⁾ will, to a large extent, limit the custody risk for investors in AIFs.
- 4.2. The ECB supports the stringent liability regime introduced by Directive 2011/61/EU and further specified in the draft delegated regulation ⁽⁶⁾. It notes, however, that this liability regime, together with future amendments (UCITS V) ⁽⁷⁾ to 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 of collective investment in transferable securities (UCITS) ⁽⁸⁾, could subject depositaries to very substantial liability claims. In the case of some depositaries, such claims could amount to losses sometimes in excess of multiples of their entire capital. The ECB therefore considers it imperative that depositaries manage these risks appropriately, whether they are credit institutions or investment firms or other supervised institutions ⁽⁹⁾, and that the risks are accounted for under the respective capital requirements rules. The forthcoming UCITS V regulatory process provides a good opportunity to address this subject with respect to UCITS as well as to AIF depositaries.

5. *Reporting requirements and exchange of information*

- 5.1. The ECB welcomes the reporting requirements set out in Article 112 of the draft delegated regulation. Under Article 112(7), AIFMs must provide the information in accordance with a pro-forma reporting template set out in the Annex to the draft delegated regulation. In this respect, the ECB supports the data reporting requirements suggested by ESMA in its advice ⁽¹⁰⁾, which provides that some information is collected on a monthly basis and suggests the provision of additional information about the historical risk profiles of AIFs. This more granular information is important for the establishment of a comprehensive systemic risk monitoring framework.

⁽¹⁾ See Chapter III, Section 5, of the draft delegated regulation.

⁽²⁾ Article 55 of the draft delegated regulation.

⁽³⁾ Article 54 of the draft delegated regulation.

⁽⁴⁾ See Chapter IV, Section 2, of the draft delegated regulation.

⁽⁵⁾ See Articles 91, 92, 98, 100 and 101 of the draft delegated regulation.

⁽⁶⁾ See Chapter IV, Section 3, of the draft delegated regulation.

⁽⁷⁾ See also the Commission Consultation paper on the UCITS depositary function and on the UCITS managers' remuneration, 14 December 2010.

⁽⁸⁾ OJ L 302, 17.11.2009, p. 32.

⁽⁹⁾ See Article 21(3) of Directive 2011/61/EU.

⁽¹⁰⁾ See Annex V to ESMA's Advice.

- 5.2. Notwithstanding the above, these reporting requirements to competent authorities, in particular those set out in paragraph 1 of Article 112 of the draft delegated regulation, overlap to a large extent with the statistical reporting requirements set out in Regulation ECB/2007/8 of 27 July 2007 concerning statistics on the assets and liabilities of investment funds ⁽¹⁾. Therefore, the ECB considers that there is potential to limit the reporting burden of AIFMs by aligning certain reporting obligations of competent authorities with the ECB's statistical requirements ⁽²⁾. In this respect, the ECB is ready and willing to discuss with the Commission and ESMA how the reporting requirements shall best be aligned.
- 5.3. Lastly, as regard the exchange of information, the draft delegated regulation ⁽³⁾ leaves national authorities with significant discretion regarding the conditions under which information relevant for the monitoring of systemic risk ⁽⁴⁾ should be shared with ESMA and the ESRB. The ECB suggests that the above provisions should be clarified in order to avoid uncertainties.

Where the ECB recommends that the draft delegated regulation is amended, specific drafting proposals are set out in the Annex accompanied by explanatory text to this effect.

Done at Frankfurt am Main, 24 May 2012.

The Vice-President of the ECB
Vitor CONSTÂNCIO

⁽¹⁾ OJ L 211, 11.8.2007, p. 8.

⁽²⁾ See paragraph 10 of Opinion CON/2009/81.

⁽³⁾ Article 7(3) and Article 118 of the draft delegated regulation.

⁽⁴⁾ Compare, in this respect, Article 3(3)(d) and Article 53 of Directive 2011/61/EU and Article 7(3) and Article 118 of the draft delegated regulation.

ANNEX

Drafting Proposals

Text drafted by the Commission	Amendments proposed by the ECB (1)
Amendment 1	
Preamble to the draft delegated regulation (new)	
<p>'Having regard to the Treaty on the Functioning of the European Union,</p> <p>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, and in particular Article 3(6) [...] and Article 53(3) thereof,</p> <p>Whereas:</p>	<p>'Having regard to the Treaty on the Functioning of the European Union,</p> <p>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, and in particular Article 3(6) [...] and Article 53(3) thereof,</p> <p>Having regard to the opinion of the European Central Bank,</p> <p>Whereas:</p>

Explanation

In accordance with Article 296 of the Treaty, which provides that legal acts shall refer to any opinions required by the Treaties, the proposed amendment is necessary in order to reflect the fact that the draft delegated regulation is adopted in accordance with Articles 127(4) and 282(5) of the Treaty. These provisions contain the obligation to consult the ECB on any proposed Union act falling within its fields of competence. As regards the ECB's advisory role regarding draft delegated and implementing acts, reference is made to paragraph 4 of ECB Opinion CON/2012/5 of 25 January 2012 on a proposal for a Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and a proposal for a Regulation on prudential requirements for credit institutions and investment firms (2).

Amendment 2

Recital 42a of the draft delegated regulation (new)

[No text]	<p>'The AIFM's senior management should approve the list of selected prime brokers. The AIFMs should appoint prime brokers from this list. Given that a prime broker may be systemically important, hedge funds should use more than one prime broker chosen from the approved list.'</p>
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Explanation

Article 27 of the draft delegated regulation establishes detailed requirements for the selection and appointment of prime brokers. The ECB supports such criteria as well as the requirement that the list of selected prime brokers must be approved by the AIFM's senior management. In addition, given that a prime broker may be systemically important for a hedge fund, the draft delegated regulation should also provide that, in principle, AIFMs must use multiple prime brokers, in line with current market practice.

Amendment 3

Article 5(6) and (7) of the draft delegated regulation (new)

[No text]	<p>'6. The notifications received pursuant to paragraph 3 shall be submitted to ESMA.</p> <p>7. ESMA may develop guidelines to foster a uniform assessment by competent authorities of the situations of a temporary nature referred to in this Article.'</p>
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Text drafted by the Commission	Amendments proposed by the ECB ⁽¹⁾
<i>Explanation</i>	
<p>The ECB welcomes the inclusion of Article 5 of the draft delegated regulation, which provides for an exemption from registration for AIFMs that occasionally breach the registration threshold. Nevertheless, some AIFMs might misuse this exemption. It would therefore be appropriate for the competent authorities to be required to submit to ESMA any notifications received from an AIFM concerning the breach of a threshold, in order to foster a common approach between national authorities in evaluating breaches of a temporary nature.</p>	
Amendment 4	
Article 46(3)(c) of the draft delegated regulation	
<p>'3. For the purposes of paragraph 1, the AIFM shall take the following actions for each AIF it manages:</p> <p>[...]</p> <p>(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;</p> <p>[...]</p>	<p>'3. For the purposes of paragraph 1, the AIFM shall take the following actions for each AIF it manages:</p> <p>[...]</p> <p>(c) conduct periodic appropriate stress tests and scenario analyses on at least a quarterly basis to address risks arising from potential changes in market conditions that might adversely impact the AIF;</p> <p>[...]</p>
<i>Explanation</i>	
<p>From a financial stability standpoint, the ECB recommends increasing the frequency of stress tests and scenario analyses, so that these are conducted on at least a quarterly basis, in order to assess an AIF's ability to withstand adverse financial, economic and idiosyncratic shocks.</p>	
Amendment 5	
Article 51(2)(e) of the draft delegated regulation	
<p>'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:</p> <p>[...]</p> <p>(e) be conducted at a frequency which is appropriate to the nature of the AIF, taking into account the investment strategy, liquidity profile, type of investor and redemption policy of the AIF, but, at a minimum, annually.'</p>	<p>'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:</p> <p>[...]</p> <p>(e) be conducted at a frequency which is appropriate to the nature of the AIF, taking into account the investment strategy, liquidity profile, type of investor and redemption policy of the AIF, but, at a minimum, on a quarterly basis annually.'</p>
<i>Explanation</i>	
<p>See explanation to amendment 4 above.</p>	
Amendment 6	
Article 117a of the draft delegated regulation (new)	
<p>[No text]</p>	<p>'In order to facilitate the establishment of cooperation arrangements and to ensure uniform application of Article 37 of Directive 2011/61/EU, ESMA may develop guidelines to determine the conditions of application of this Section.'</p>
<i>Explanation</i>	
<p>The ECB supports collaboration between the competent authorities in Member States and third countries by means of cooperation agreements. In this respect, coordination between Member States is essential in order to minimise inconsistencies in their policies. The direct involvement of ESMA, in accordance with Article 37(16) and (17) of Directive 2011/61/EU, would help to ensure a consistent approach between Member States towards third countries.</p>	
<p>(¹) Bold in the body of the text indicates where the ECB proposes inserting new text. Strikethrough in the body of the text indicates where the ECB proposes deleting text. (²) OJ C 105, 11.4.2012, p. 1.</p>	