IAA Submission in Response to EC AIFMD Consultation, January 28, 2021

The IAA has responded to certain of the questions in the European Commission's ("EC's" or "Commission's") consultation document on the Alternative Investment Fund Managers Directive ("AIFMD"),[1] by filing the responses below on the EC website. The IAA's responses are limited to the **International Relations (Delegation)** and **Sustainability/ESG** sections of the consultation.

Section III. International Relations (Delegation)

Question 48. Which elements of the AIFMD regulatory framework could be altered to enhance competitiveness of the EU AIF industry?

Response: General Response: The Investment Adviser Association ("IAA") appreciates the opportunity to respond to the European Commission's ("EC's" or "Commission's") AIFMD Consultation. The IAA is a not-for-profit U.S. association that represents the interests of investment adviser firms registered with the U.S. Securities and Exchange Commission ("SEC"). Our members manage assets for a wide variety of individual and institutional clients, including pension plans, trusts, investment funds, endowments, foundations, and corporations, and many of our members manage, or have affiliates that manage, assets for European clients. For more information, please visit our website: www.investmentadviser.org.

The Consultation is issued as a part of the EC's formal review of AIFMD and follows the EC's related report to the European Parliament and Council ("EC Report"). The EC Report concluded that the AIFMD has contributed to the creation of the EU alternative investment fund ("AIF") market, provided a high level of protection to investors, and facilitated monitoring of risks to financial stability. We understand that the AIFMD requires a Commission review, but that does not mean that the Commission should make changes where the current framework functions effectively, as it does in the area of third-party delegation. The delegation rules under Article 20 of the AIFMD and the delegation framework in Article 82 of Delegated Regulation 2013/231 (Alternative Investment Fund Managers Regulations or "AIFMR") are robust and work well for EU AIFs and their investors. Significant changes in this area would make third-party delegation more difficult and would likely increase confusion, costs, and compliance burdens and limit EU investor access and choice without meaningful benefits for funds or investors. In fact, we have serious concerns that limiting or making delegation more difficult would hurt EU investors by limiting their access to the expertise and strategies of non-EU alternative investment fund

[1] European Commission, Consultation Document, Public Consultation on the Review of the AIFMD (Oct. 22, 2020), available at https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/2020-aifmd-review-consultation-document_en.pdf (noting the global nature of financial services and how the AIFMD interacts with the third country regulatory regimes. The EC notes that the AIFMD is a legal framework for tackling risks emanating from AIF activities that may impact the EU financial stability, market integrity and investor protection.)

managers ("AIFMs"). We thus urge the Commission to preserve the current longstanding and well-regulated delegation framework and refrain from imposing restrictions and burdens that would make delegation more difficult and costly.

Specific Response: The IAA believes that the competitiveness of the EU AIF industry is strong and that it is not necessary to alter any elements of the delegation regulatory framework to enhance competitiveness of the EU AIF industry. We do not believe that that framework favors non-EU AIFMs. In our view, the parameters and guardrails in the delegation framework fairly permit portfolio managers from third countries, including the United States, to efficiently and effectively execute portfolio management decisions for an EU AIF while protecting the ongoing competitiveness of the EU AIFM sector and allowing EU investors to access the expertise and strategies of third-country managers. In addition, the guardrails against letter-box entities in the EU ensure that an AIF's functions are appropriately delegated.

Question 49. Do you believe that national private placement regimes create an uneven playing field between EU and non-EU AIFMs?

Response: Our response to question 49 is "No." We needed to select "Yes" to enable us to explain our response.

Question 49.1. If you believe there is an uneven playing field between EU and non-EU AIFMs, which action would you suggest to address the issue?

Please explain your choice, presenting benefits and disadvantages of the potential changes to the AIFMD as well as potential costs associated with your preferred option:

Response: Our response to question 49 is "No." We needed to select "Yes" to enable us to explain our response. National private placement regimes ("NPPRs") do not create an uneven playing field between EU and non-EU AIFMs. For many non-EU AIFMs, it is not economically or operationally feasible to have an EU AIFM. In the absence of a third-country registration/passport, the NPPR is important. NPPRs require registration to market an AIF under the NPPR, and the third-country manager makes certain declarations and ensures compliance. The NPPR provides investors in EU countries with choice and protecting that choice is important. EU investors should be able to access these products if the non-EU AIFM is complying with the appropriate country-level NPPR requirements. More broadly, when considering the rules for distribution of investment funds globally as the relevant "playing field," it is clear that EU AIFMs are not at a disadvantage to non-EU AIFMs. As an example, an EU AIFM is able to market its fund to investors in the United States that meet a "qualified purchaser" test without being subject to any substantial compliance requirements as would apply to a U.S. AIFM marketing an AIF in the EU.

Question 50. Are the delegation rules sufficiently clear to prevent creation of letter-box entities in the EU?

Response: Yes. Our response to question 50 is "Yes." We needed to select "No" to enable us to explain our response.

Question 50.1. Please explain your answer to question 50.

Response: Our response to question 50 is "Yes." We needed to select "No" to enable us to explain our response. As discussed above, the IAA believes that the delegation framework of the AIFMD adequately prohibits a third party from being engaged as a "letter-box entity," i.e., where an EU AIFM would effectively no longer be considered to be managing an EU AIF. The conditions and protections under Article 82 of AIFMR are sufficient to provide the appropriate balance between investor protection and support for the management company's business.

Both the AIFMD and UCITS regimes have long relied on a significant degree of outsourcing of investment decision-making to "third countries" such as the United States. The IAA is not aware of any evidence that would support substantial revisions to the AIFMD. Under the current requirements, if firms delegate portfolio management to a third country, they retain significant risk management functions in the EU. Therefore, a letter-box entity is not an available option today. Given the strong compliance with the current regime's prohibition against letter-box entities, there is no need for the EC to change the AIFMD delegation requirements.

Question 51. Are the delegation rules under the AIFMD/AIFMR appropriate to ensure effective risk management?

Response: Yes. Our response to question 51 is "Yes." We needed to select "No" to enable us to explain our response.

Question 51.1. Please explain your answer to question 51, presenting benefits and disadvantages of the current rules and where available providing concrete examples substantiating your answer:

Response: Our response to question 51 is "Yes." We needed to select "No" to enable us to explain our response. We believe that current rules are appropriate to ensure effective risk management. These rules require approvals for or limit the types of entities that can perform risk management functions and require that the EU AIFM remains responsible for risks arising from any delegation to a third party.

Question 52. Should the AIFMD/AIFMR delegation rules, and in particular Article 82 of the Commission Delegated Regulation (EU) No 231/2013, be complemented?

Response: No.

Question 53. Should the AIFMD standards apply regardless of the location of a third party, to which AIFM has delegated the collective portfolio management functions, in order to ensure investor protection and to prevent regulatory arbitrage?

Response: No.

Question 53.1. Please explain your answer to question 53.

Response: We do not believe this is necessary. Our members' experience has shown that the current framework provides a high degree of investor protection and does not appear to subject EU AIFs to regulatory arbitrage. For example, experience has shown that an AIF's risk management function that is conducted in the EU has the appropriate oversight by an EU national competent authority, while its portfolio management function can be conducted outside of the EU with appropriate registration with and oversight by a third-country regulator, such as the SEC in the United States.

Question 55. Which elements of the AIFMR delegation rules could be applied to UCITS? Please explain your position, presenting benefits and disadvantages of the potential changes as well as costs:

Response: We do not believe that any elements of the AIFMR delegation rules should be applied to UCITS. There is a longer experience with delegation under UCITS, and we have confidence that that framework works well. There is no compelling reason to impose AIFMD rules on UCITS, not only because the UCITS framework works well but also because the regulatory focus of the two regimes differs significantly. AIFMD is focused on managers of nonpublic funds, whereas UCITS is focused on publicly offered products for retail investors.

Section VI. Sustainability/ESG

Question 90. The disclosure regulation 2019/2088 [SFDR] defines sustainability risks, and allows their disclosures either in quantitative or qualitative terms.
Should AIFMs only quantify such risks?

Response: No.

Question 90.1. Please substantiate your answer to question 90, also in terms of benefits, disadvantages and costs as well as in terms of available data:

Response: AIFMs should not be required to quantify sustainability risks. SFDR allows for quantitative and qualitative disclosure of sustainability risks, because both types of disclosure can provide meaningful information. Not all sustainability risks can be quantified and there is no widely-accepted method to quantify these risks. Requiring quantitative information that may not be meaningful would not be helpful to investors.

We also believe that the Commission should not amend the requirements in connection with SFDR but instead should focus on the implementation of that regulation.

Question 91. Should investment decision processes of any AIFM integrate the assessment of

non-financial materiality, i.e. potential principal adverse sustainability impacts?

Response: No.

Question 91.1. Please substantiate your answer to question 91, also in terms of benefits, disadvantages and costs. Please make a distinction between adverse impacts and principal adverse impacts and consider those types of adverse impacts for which data and methodologies are available as well as those where the competence is nascent or evolving.

Response: As stated in the Consultation's Introduction to this Section, asset managers are required to integrate in their due diligence processes an assessment of relevant sustainability risks. Sustainability risks are those that may have a material negative impact on the financial return of an investment or advice. AIFMs should not be required to assess those impacts that do not rise to the level of sustainability risks, unless an assessment of those impacts is consistent with an AIF's investment mandate. SFDR requires disclosure of principal adverse impacts in order to provide transparency to investors. Requiring disclosure about principal adverse impacts is significantly different than requiring consideration of those impacts as part of the investment decision making process.

We are concerned that a requirement to integrate the assessment of impacts that do not rise to the level of sustainability risks into the investment decision making process could result in asset managers making decisions that are outside the mandates agreed to with their clients and also not in their clients' best interest. An asset manager should focus on those factors that assist it in determining whether a particular investment is in the best interest of its client. In addition, as we discuss in our response to question 90.1, we believe that the Commission should not amend the requirements in connection with SFDR but should focus on implementation of that regulation.

Question 92. Should the adverse impacts on sustainability factors be integrated in the quantification of sustainability risks (see the example in the introduction)?

Response: Fully disagree.

Question 92.1. Please explain your answer to question 92.

Response: Asset managers are required to integrate in their due diligence processes an assessment of relevant sustainability risks. As we discuss in our response to question 91.1, asset managers should not be required to integrate the assessment of impacts that are not sustainability risks into the investment decision making process. Sustainability risks and adverse impacts each have separate obligations associated with them under SFDR. An adverse impact may rise to the level of a sustainability risk, at which point the impact would be considered as part of the investment process. The Commission should keep these concepts separate, and not take action that confuses the distinction between them. Eliminating the distinction between these concepts would cause investor confusion and would dilute the ability of asset managers to focus on their clients' particular investment objectives. Regarding quantification, as we discuss in our response to question 90.1, we do not believe that asset managers should be required to quantify

sustainability risks.

Question 93. Should AIFMs, when considering investment decisions, be required to take account of sustainability-related impacts beyond what is currently required by the EU law (such as environmental pollution and degradation, climate change, social impacts, human rights violations) alongside the interests and preferences of investors?

Response: No.

Question 93.1. Please explain your answer to question 93:

Response: Asset managers have a fiduciary duty to their clients, and thus must focus on the interests and preferences of their clients. We are concerned that requiring asset managers to focus on other impacts would dilute their duty to act in the best interest of their clients. An AIFM should be required to focus on the AIF's investment mandate when making investment decisions, rather than other impacts. Depending on an AIF's investment objective and strategy, that may involve focusing on sustainability impacts, but that should not be required for all asset managers in all situations. An AIFM must have the ability to make decisions and consider factors that it, in its expert judgement, reasonably believes advance the AIF's investment mandate.

Question 94. The EU Taxonomy Regulation provides a framework for identifying economic activities that are in fact sustainable in order to establish a common understanding for market participants and prevent green-washing. To qualify as sustainable, an activity needs to make a substantial contribution to one of six environmental objectives, do no significant harm to any of the other five, and meet certain social minimum standards. In your view, should the EU Taxonomy play a role when AIFMs are making investment decisions, in particular regarding sustainability factors?

Response: No.

Question 94.1. Please explain your answer to question 94:

Response: The EU Taxonomy should not play a role when AIFMs are making investment decisions. Article 8 and Article 9 funds are required to report alignment with the EU Taxonomy, but the EU Taxonomy was not intended to play a role in investment decisions. The reporting obligations should not be extended across AIFMs, and the Commission should avoid mandating that the Taxonomy be used for purposes other than what was originally intended. The Commission has not yet developed the full technical screening criteria, nor has it had an opportunity to observe the implementation of the EU Taxonomy and is not in a position to draw conclusions about its effectiveness. In addition, not all issuers are required to disclose their Taxonomy alignment, meaning that asset managers will not have this information across all investments. The Commission should wait until the technical screening criteria are fully developed, and the original Taxonomy Regulation is implemented before considering whether to extend its reporting obligations to other asset managers or imposing additional requirements in this area.

Question 95. Should other sustainability-related requirements or international principles beyond those laid down in the EU Taxonomy Regulation be considered by AIFMs when making investment decisions?

Response: No.

Question 95.1. Please explain your answer to question 95, describing sustainability-related requirements or international principles that you would propose to consider. Please indicate, where possible, costs, advantages and disadvantages associated therewith:

Response: As we discuss in our response to question 93.1, asset managers have an obligation to and focus on the interests and preferences of their clients. We are concerned that requiring asset managers to focus on other requirements or principles would dilute their duty to act in the best interest of their clients. An AIFM should be required to focus on the AIF's investment mandate when making investment decisions.

* * *