



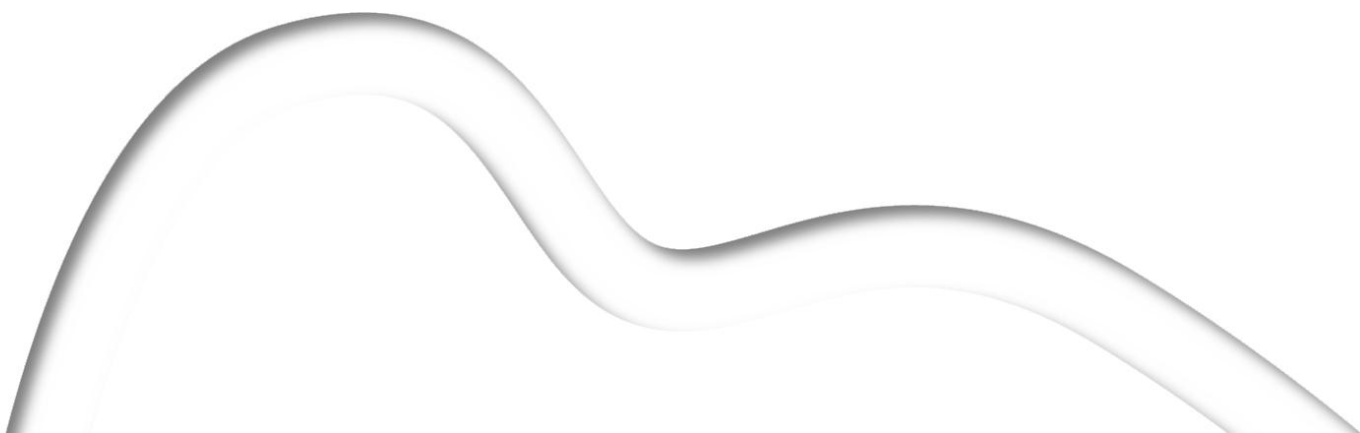
**Financial Services
Commission**

Information page

Alternative Investment Fund Managers Directive Delegation

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Any advice or interpretation covered in this information page represents the views of the FSC as to its expectations of how the requirements of the AIFMD are to be complied with and/or how it fails to be applied. This however is not intended as a definitive interpretation of the AIFMD which is ultimately a matter for the courts to determine. The FSC does not provide, or purport to offer, legal advice.



1. Introduction

- 1.1 In this information page, reference is made to the Alternative Investment Fund Managers Directive 2011/61/EU ("AIFMD") and to the supplementing Level 2 Delegated Regulation ("Level 2").
- 1.2 The AIFMD requires Alternative Investment Fund Managers ("AIFMs") to carry out certain specific functions. However, AIFMD also allows AIFMs to delegate certain functions in certain circumstances and in accordance with applicable rules.
- 1.3 The purpose of this information page is to provide AIFMs with clear information, based on the information on the AIFMD and Level 2, on the manner in, and to the extent to, which they can delegate certain functions that they are required to carry out in under AIFMD.

2. Delegation – Higher level requirements

Article 20 of AIFMD covers the higher level requirements in respect of AIFM delegation, supplementing information on the main requirements are set out below.

- 2.1 AIFMs which intend to delegate to third parties the task of carrying out functions on their behalf must notify the FSC before the delegation arrangements become effective.
- 2.2 The following conditions shall be met:
- (a) the AIFM must be able to justify its entire delegation structure on objective reasons; *(see section 4 below for further information from Level 2).*
 - (b) the delegate must have of sufficient resources to perform the respective tasks and the persons who effectively conduct the business of the delegate must be of sufficiently good repute and sufficiently experienced; *(see section 5 below for further information from Level 2).*
 - (c) where the delegation concerns portfolio management¹ or risk management², it must be conferred only on undertakings which are authorised or registered for the purpose of asset management and subject to supervision or, where that condition cannot be met, only subject to prior approval by the FSC; *(see section 6 below for further information from Level 2).*
 - (d) where the delegation concerns portfolio management or risk management and is conferred on a third-country undertaking, in addition to the requirements in paragraph (c), cooperation between the FSC and the supervisory authority of the undertaking must be ensured;
 - (e) the delegation must not prevent the effectiveness of supervision of the AIFM, and, in particular, must not prevent the AIFM from acting, or the AIF from being managed, in the best interests of its investors; *(see section 7 below for further information from Level 2) and*

¹ 'portfolio management' means management of the investments of an AIF in accordance with a defined investment policy for the benefit of the investors of that AIF.

² 'risk management' means policies and procedures related to the management of risk relevant to each AIF (for further information refer to the FSC information page on "AIFMD – Risk Management").



- (f) the AIFM must be able to demonstrate that the delegate is qualified and capable of undertaking the functions in question, that it was selected with all due care and that the AIFM is in a position to monitor effectively at any time the delegated activity, to give at any time further instructions to the delegate and to withdraw the delegation with immediate effect when this is in the interest of investors. *(see section 3 below for further information from Level 2).*
- 2.3 The AIFM must review the services provided by each delegate on an on-going basis.
- 2.4 No delegation of portfolio management or risk management shall be conferred on:
- (a) the depositary or a delegate of the depositary; or
 - (b) any other entity whose interests may conflict with those of the AIFM or the investors of the AIF, unless that entity has functionally and hierarchically separated the performance of its portfolio management or risk management tasks from its other potentially conflicting tasks, and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF. *(see section 8 below for further information from Level 2).*
- 2.5 The AIFM's liability towards the AIF and its investors shall not be affected by the fact that the AIFM has delegated functions to a third party, or by any further sub-delegation, nor shall the AIFM 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. *(see section 10 below for further information from Level 2).*
- 2.6 The third party may sub-delegate any of the functions delegated to it provided that the following conditions are met:
- (a) the AIFM consented prior to the sub-delegation;
 - (b) the AIFM notified the FSC before the sub-delegation arrangements become effective; and
 - (c) the conditions set out in subsection (2), on the understanding that all references to the 'delegate' are read as references to the 'sub-delegate'. *(see section 9 below for further information from Level 2).*
- 2.7 No sub-delegation of portfolio management or risk management shall be conferred on:
- (a) the depositary or a delegate of the depositary, or
 - (b) any other entity whose interests may conflict with those of the AIFM or the investors of the AIF, unless such entity has functionally and hierarchically separated the performance of its portfolio management or risk management tasks from its other potentially conflicting tasks, and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF.
- 2.8 The relevant delegate shall also review the services provided by each sub-delegate on an on-going basis.
- 2.9 Where the sub-delegate further delegates any of the functions delegated to it, the conditions set out in section 2.6 shall apply (with any necessary modifications).

3. General principles

Article 75 of Level 2

- 3.1 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 the AIFMD 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.

4. Objective reasons for delegation

Article 76 of Level 2

- 4.1 The AIFM shall provide the FSC 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 section 2.2(a) above 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.
- 4.2 Upon request by the FSC, an AIFM shall provide further explanations and provide documents proving that the entire delegation structure is based on objective reasons.

5. Features of the delegate

Article 77 of Level 2

- 5.1 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.
- 5.2 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.
- 5.3 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.
- 5.4 Where the delegate is regulated in respect of its professional services within the EU, factors referred to in section 5.3 above 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.

6. Delegation of portfolio or risk management

Article 78 of Level 2

- 6.1 This Article shall apply where the delegation of portfolio management or risk management is concerned.
- 6.2 The following entities shall be deemed to be authorised or registered for the purpose of asset management and subject to supervision in accordance with section 2.2(c) above:
- (a) management companies authorised under Directive 2009/65/EC (on UCITS);
 - (b) investment firms authorized under Directive 2004/39/EC (MiFID) to perform portfolio management;
 - (c) credit institutions authorised under Directive 2006/48/EC (on credit institutions) having the authorisation to perform portfolio management under Directive 2004/39/EC (MiFID);
 - (d) external AIFMs authorised under AIFMD;
 - (e) third country entities authorised or registered for the purpose of asset management and effectively supervised by a competent authority in those countries.
- 6.3 Where the delegation is conferred on a third-country undertaking the following conditions shall be fulfilled in accordance with section 2.2(d) above:
- (a) a written arrangement shall exist between the FSC 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 FSC to:
 - (i) obtain on request the relevant information necessary to carry out their supervisory tasks as provided for in the AIFMD;
 - (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 the AIFMD 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 the AIFMD and its implementing measures and relevant national law.

AIFMs wanting to go down this option should liaise with the FSC prior to finalising its own arrangements so that these requirements can be adequately catered for.

7. Effective supervision

Article 79 of Level 2

- 7.1 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 the AIFMD and its implementing measures.

8. Conflicts of interest

Article 80 of Level 2

- 8.1 In accordance with section 2.4(b) above, 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.
- 8.2 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 (i.e. risk management, compliance, internal audit and similar functions);

- (b) persons engaged in risk management tasks are not engaged in the performance of potentially conflicting tasks such as operating tasks (e.g. portfolio management);
 - (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.
- 8.3 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 of Level 2.
 - (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 of Level 2.

9. Consent and notification of sub-delegation

Article 81 of Level 2

- 9.1 A sub-delegation shall become effective where the AIFM demonstrates its consent to it in writing.
- 9.2 A general consent given in advance by the AIFM shall not be deemed consent in accordance with section 2.6(a) above.
- 9.3 Pursuant to section 2.6(b) above, 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.

10. Determination of AIFM as a letter box entity

Article 82 of Level 2

- 10.1 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.

10.2 ESMA may issue guidelines to ensure a consistent assessment of delegation structures across the EU.

11. Functions of the AIFM

Annex I of the AIFMD (reproduced below) lists the functions of the AIFM.

- 11.1 Investment management functions which an AIFM shall at least perform when managing an AIF:
 - (a) portfolio management;
 - (b) risk management.
- 11.2 Other functions that an AIFM may additionally perform in the course of the collective management of an AIF:
 - (a) Administration
 - (i) legal and fund management accounting services;
 - (ii) customer inquiries;
 - (iii) valuation and pricing, including tax returns;
 - (iv) regulatory compliance monitoring;
 - (v) maintenance of unit-/shareholder register;
 - (vi) distribution of income;
 - (vii) unit/shares issues and redemptions;
 - (viii) contract settlements, including certificate dispatch;



- (ix) record keeping;
- (b) Marketing;
- (c) Activities relating to the assets of AIFs, namely services necessary to meet the fiduciary duties of the AIFM, facilities management, real estate administration activities, advice to undertakings on capital structure, industrial strategy and related matters, advice and services relating to mergers and the purchase of undertakings and other services connected to the management of the AIF and the companies and other assets in which it has invested.

12. Application of implementing measures

Any measures adopted by the European Union Commission under Article 20(7) of the AIFMD will also be applicable.