



Regulatory Challenges Faced by ManCos/AIFMS

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DUFF & PHELPS
A **KROLL** BUSINESS

Agenda

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Anil Singh

Managing Director
Head of Luxembourg Manco/AIFM
+352 2610880621
Anil.Singh@duffandphelps.com

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Ryan McNelley

Managing Director
Head of Portfolio Valuation Services – EMEA
+44 (0)20 7089 4822
Ryan.McNelley@duffandphelps.com

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Anadia Ledo

Senior Associate
Luxembourg Manco/AIFM
+352 2610880629
Anadia.Ledo@duffandphelps.com

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Introduction

ABOUT DUFF & PHELPS, A KROLL BUSINESS

For **nearly 100 years**, Duff & Phelps has helped clients make confident decisions in the areas of valuation, real estate, taxation and transfer pricing, disputes, M&A advisory and other corporate transactions.

Kroll is the world's premier provider of services and digital products related to **governance, risk and transparency**. We work with clients across diverse sectors in the areas of valuation, expert services, investigations, cyber security, corporate finance, restructuring, legal and business solutions, data analytics and regulatory compliance.

The firm's nearly **5,000 professionals** are located in **30 countries and territories** around the world.

~5,000
TOTAL PROFESSIONALS
GLOBALLY

13,400
CLIENTS INCLUDING
NEARLY
48% OF THE
S&P 500

THE
AMERICAS
2,700+
PROFESSIONALS

EUROPE AND
MIDDLE EAST
1,250+
PROFESSIONALS

ASIA
PACIFIC
950+
PROFESSIONALS

OUR LOCATIONS

Across 30 countries and territories worldwide



THE AMERICAS

Addison	Houston	San Francisco
Atlanta	Los Angeles	São Paulo
Austin	Mexico City	Seattle
Bogota	Miami	Secaucus
Boston	Minneapolis	Silicon Valley
Buenos Aires	Morristown	St. Louis
Chicago	Nashville	Toronto
Dallas	New York	Washington, D.C.
Denver	Philadelphia	Waterbury
Ellensburg	Reston	Westchester

EUROPE AND MIDDLE EAST

Abu Dhabi	Dublin	Moscow
Agrate Brianza	Frankfurt	Munich
Amsterdam	Gibraltar	Padua
Barcelona	Lisbon	Paris
Bari	London	Pesaro
Berlin	Longford	Riyadh
Bilbao	Luxembourg	Rome
Birmingham	Madrid	Turin
Channel Islands	Manchester	Zurich
Dubai	Milan	

ASIA PACIFIC

Bangalore	New Delhi
Beijing	Shanghai
Guangzhou	Shenzhen
Hanoi	Singapore
Hong Kong	Sydney
Hyderabad	Taipei
Jakarta	Tokyo
Kuala Lumpur	
Mumbai	

CARIBBEAN

British Virgin Islands
Cayman Islands

STRATEGIC PARTNERS

Almaty
Athens
Limassol
Moscow

ENHANCING VALUE ACROSS A RANGE OF EXPERTISE

Our service areas



VALUATION ADVISORY

Valuation and consulting for financial reporting, tax, investment and risk management purposes

- Valuation Services
- Alternative Asset Advisory
- Real Estate Advisory
- Tax Services
- Transfer Pricing
- Fixed Asset Management and Insurance Solutions



CORPORATE FINANCE

Objective guidance to management teams and stakeholders throughout restructuring, financing and M&A transactions, including independent fairness and solvency opinions

- M&A Advisory
- Fairness and Solvency Opinions
- Transaction Advisory Services
- ESOP and ERISA Advisory
- Private Equity - Financial Sponsors Group
- Distressed M&A and Special Situations
- Private Capital Markets and Debt Advisory



GOVERNANCE, RISK, INVESTIGATIONS AND DISPUTES

Risk management and mitigation, disputes and other advisory services

- Business Intelligence and Investigations
- Financial Services Compliance and Regulation
- Compliance Risk and Diligence
- Cyber Risk
- Disputes Consulting
- Global Restructuring Advisory
- Legal Management Consulting
- Security Risk Management
- Management Company/AIFM



BUSINESS SERVICES

Complex legal and business solutions through our proprietary technology and team of experts

- Prime Clerk Restructuring
- Kroll Corporate Actions
- Lucid Issuer Services
- Lucid Agency and Trustee Services
- Kroll Class Action Administration
- Kroll Mass Tort Administration
- Kroll Notice Media Solutions
- Kroll Business Technology
- Kroll Agency Cloud

BRAND TRANSITION

Past

Present

Future

DUFF & PHELPS



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KROLL



02

An overview of the main regulatory challenges faced by ManCos/AIFMs

List of guidelines/regulations

12-Nov-20	ESMA – Third annual report on use of sanctions for UCITS
12-Nov-20	ESMA – First annual report on use of sanctions under AIFMD
19-Nov-20	CSSF – Communication by the UK Financial Conduct Authority (FCA) to Luxembourg-based entities regarding the UK Temporary Permissions Regime (TPR)
24-Nov-20	CSSF – Law of 17 December 2010 - Updated FAQ
08-Dec-20	CSSF – New eDesk module for two types of requests
16-Dec-20	Ministry of Justice – Updated national risk assessment of money laundering and terrorist financing
16-Dec-20	CSSF – Communication on regulatory requirements and fast track procedure in relation to Regulation (EU) 2019/2088 on the sustainability-related disclosures in the financial services sector
18-Dec-20	CSSF – Guidelines on performance fees in UCITS and certain types of AIFs
24-Dec-20	CSSF – Regulation No 20-09 on the equivalence of certain third countries with respect to supervision and authorization rules for the purpose of providing investment services or performing investment activities and ancillary services by third-country firms
24-Dec-20	CSSF – 2020 Survey related to the fight against money laundering and terrorist financing

List of guidelines/regulations continued..

30-Dec-20	CSSF – Regulation No 20-10 of 21 December 2020
13-Jan-21	ESMA – Public statement on the reverse solicitation under MIFID
20-Jan-21	CSSF – Law of 12 July 2013 on alternative investment fund managers – Updated FAQ
25-Jan-21	Ministry of Justice – First money laundering and terrorist financing vertical risk assessment on virtual asset service providers
01-Feb-21	AED – AML/CFT Questionnaire related to the fight against money laundering and financing of terrorism
03-Feb-21	ESAs – PRIIPs Key Information Document
04-Feb-21	ESAs – Final report on the draft RTS on disclosures under SFDR
08-Feb-21	CSSF – AML/CFT Market Entry Form
23-Feb-21	CSSF – Submission process for a new sub-fund
25-Feb-21	Luxembourg Parliament – Law of 25 February 2021
03-Mar-21	Circular CSSF 21/767 – FATF statements (repealing Circular CSSF 20/754 of 28 Oct 2020)

List of guidelines/regulations continued..

24-Mar-21	ESMA – 2020 Common Supervisory Action on UCITS liquidity risk management
30-Mar-21	ESMA – Q&A on the application of the UCITS Directive
30-Mar-21	ESMA – Q&A on the application of the AIFMD
31-Mar-21	ESMA – Q&A on the Prospectus Regulation
08-Apr-21	ESMA – Annual statistical report on the Alternative Investment Fund sector
09-Apr-21	CSSF – Circular CSSF 21/769 on governance and security requirements for Supervised Entities to perform tasks or activities through Telework
13-Apr-21	Circular CSSF 21/770 on ESMA guidelines on the reporting under Articles 4 and 12 SFTR
14-Apr-21	ESMA – Annual statistical report on the cost and performance of EU retail investment products
20-Apr-21	CSSF – Circular CSSF 21/771 on application of the guidelines of the European Securities and Markets Authority on disclosure requirements under the Prospectus Regulation

List of guidelines/regulations further continued.....

21-Apr-21	European Commission – Delegated Regulation and Annex correcting Delegated Regulation (EU) 2017/565 supplementing MiFID II
05-May-21	ESMA – Q&A on the Prospectus Regulation
20-May-21	ALFI – AML guidelines
21-May-21	Chamber of Deputies - Bill of Law amending the Law of 22 March 2004 on Securitisation
27-May-21	ESMA – Guidelines on marketing communications
28-May-21	ESMA – Q&A on the application of the UCITS Directive
28-May-21	ESMA – Q&A on the application of the AIFMD
10-Jun-21	CSSF – FAQ concerning the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment
10-Jun-21	CSSF – FAQ concerning the Luxembourg Law of 12 July 2013 on alternative investment fund managers

Challenges

- Ever changing regulatory landscape:
 - Regulator's expectations/substance requirements
 - Risk management
 - Capital raising/distribution
 - Prevention of money laundering
 - Increased reporting requirements
 - Increased sanctions
- Cybersecurity
- Higher client expectations
- Increasing competition
- Complexities of cross border regulations
- Brexit
- COVID-19 and hybrid working environment

Challenges

- Resulting in :
 - Higher cost base
 - Businesses operating at loss
 - Fight for talent
 - Not much standardization or IT
 - Varied practices/capabilities
 - Risk of cutting corners

Hats off to compliance officers and business leaders navigating these tough waters !!!!

Possible solution !!

- Multiple regulated entities within the same group?
 - Plight of COOs & CCOs
- Or outsource to global, reputed, specialized, well-capitalized third party ManCo/AIFM?



03

Ways to ensure your valuation function meets both regulatory standards and investor requirements

2021 and the K-Shaped Recovery



- Economic outlook is key to any valuation
- Government support and the restructuring wall
- Distressed/special situations funds and dry powder
- Emerging markets, country risk premium and the drawn-out impact of COVID
- US SPAC Boom

Luxembourg, Dublin and the Third-Party AIFM

- Luxembourg and Dublin have become destinations for fund domiciliation:
 - Concentration of professional services
 - AIFMD passporting
 - Tax and regulatory efficiency
- Beware, however, the risks and obligations:
 - Varied practices / capabilities amongst third-party AIFMs
 - Responsibility for NAV
 - Regulators taking closer order
 - SM&CR in the UK



"That woke me up, too!"

Valuation standards for third party AIFMs should match those of the traditional LP/GP construct

Pricing Policies: Fair Value – vs – Amortised Cost:

Fair Value Considerations for Limited Partners

Limited Partners in Private Equity funds universally *require* Fair Value for their own financial reporting purposes. Moreover, limited partners overwhelmingly demand Fair Value because:

- ✓ Most LPs accounting rules require them to record their Fund Interests at Fair Value, and thus they require Fair Value based NAVs from underlying GPs;
- ✓ Fair Value is the basis upon which limited partners make decisions:
 - ✓ asset allocation and rebalancing decisions
 - ✓ secondary market transaction decisions, and
 - ✓ incentive compensation decisions;
- ✓ Fair Value is the basis for any Risk Management framework.

Amortised Cost (in contrast) is:

- A historical recording of the price paid for an asset – not an indication of what it's worth today
- Does not react to market and economic conditions (e.g., the COVID economic crisis, Great Financial Crisis, Eurozone crisis, Greek market suspension, Chinese A-Share de-listings, Brexit volatility/uncertainty, etc., etc., etc.)
- Not relevant for decision making purposes for LPs (e.g., investment allocation)

3rd Party Valuation Support

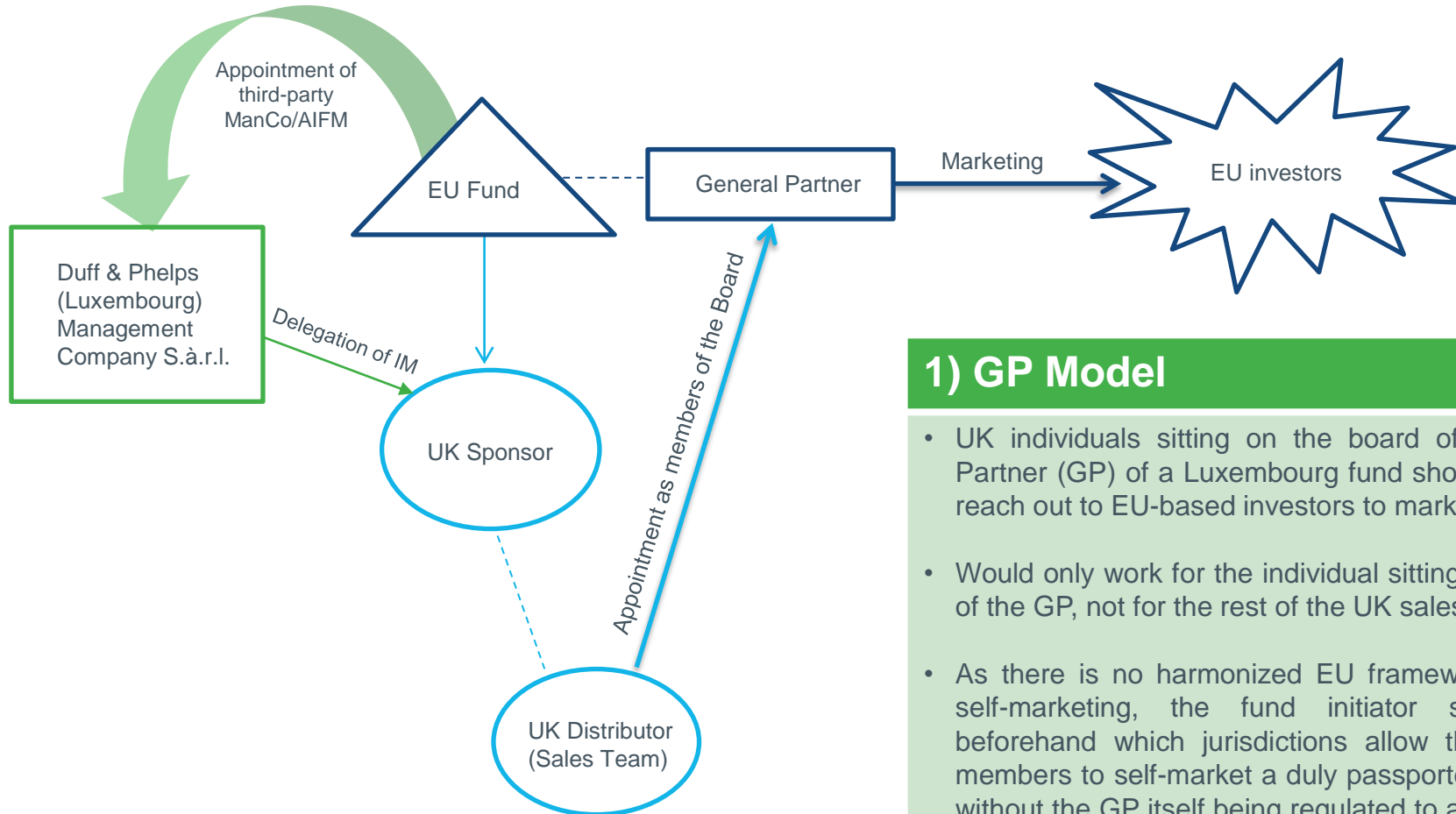
	Transaction Opinion	External Valuer (as defined by AIFMD)	Independent Valuation	Positive Assurance
Context and Purpose	A Transaction Opinion is typically sought in the context of a related-party transaction, where the client is on both sides of a transaction, and wants to preempt any potential accusation that the transaction consideration is biased in favour of one set of investors	A formal appointment under the AIFM Directive. A delegation by the AIFM of the Fair Value determination for NAV reporting purposes	Independent valuation used by either the AIFM or the Investment Manager/Advisor (who may or may not also be the AIFM) to corroborate their own estimations of Fair Value in order to demonstrate independence in the NAV reporting process	A validation of the estimations of Fair Value (for NAV reporting purposes) made by either the AIFM or the Investment Manager / Advisor (who may or may not also be the AIFM) in order to demonstrate independence in the NAV reporting process
Risk Considerations	Opinion specifically on a related party transaction where the potential exists for disputes or allegations of inappropriate governance. Duff & Phelps may be called upon after the transaction closes to support/defend conclusions	Independent valuation for NAV reporting purposes. However, External Valuer prohibited (by AIFM Directive) from capping liability to AIFM. No reference made to any contemplated transaction	Independent valuation for NAV reporting purposes (no reference made to any transaction). No reference made to any contemplated transaction. Financial liability is capped	Independent valuation for NAV reporting purposes (no reference made to any transaction). No reference made to any contemplated transaction. Financial liability is capped
Scope	Full scope procedures as defined by Duff & Phelps	Limited Scope procedures as defined by Duff & Phelps as External Valuer	Limited Scope procedures as defined by client	Limited Scope procedures as defined by client
Site Visit(s)	As deemed appropriate by Duff & Phelps	As deemed appropriate by Duff & Phelps as External Valuer	As requested by client (but not typical)	As requested by client (but not typical)
Form of Opinion	Opinion as to whether a transaction is "Fair from a financial point of view" to either buyer or seller (1-sided opinion) or to both parties (2-sided opinion)	Point Estimate of Fair Value	Estimated Range of Fair Values	Opinion as to whether Investment Manager's concluded Fair Value is "reasonable"
Form of Report	Short-Form letter addressed to the BoD or LPAC. Accompanying PowerPoint presenting quantitative support for conclusions	Narrative letter report (typically with 5 to 10 pages of narrative per investment)	Narrative letter report (typically with 5 to 10 pages of narrative per investment). "Short-Form" reports and other 'customised' reporting available	Narrative letter report (typically with 5 to 10 pages of narrative per investment). "Short-Form" reports and other 'customised' reporting available



04

Cross-border
distribution after
Brexit

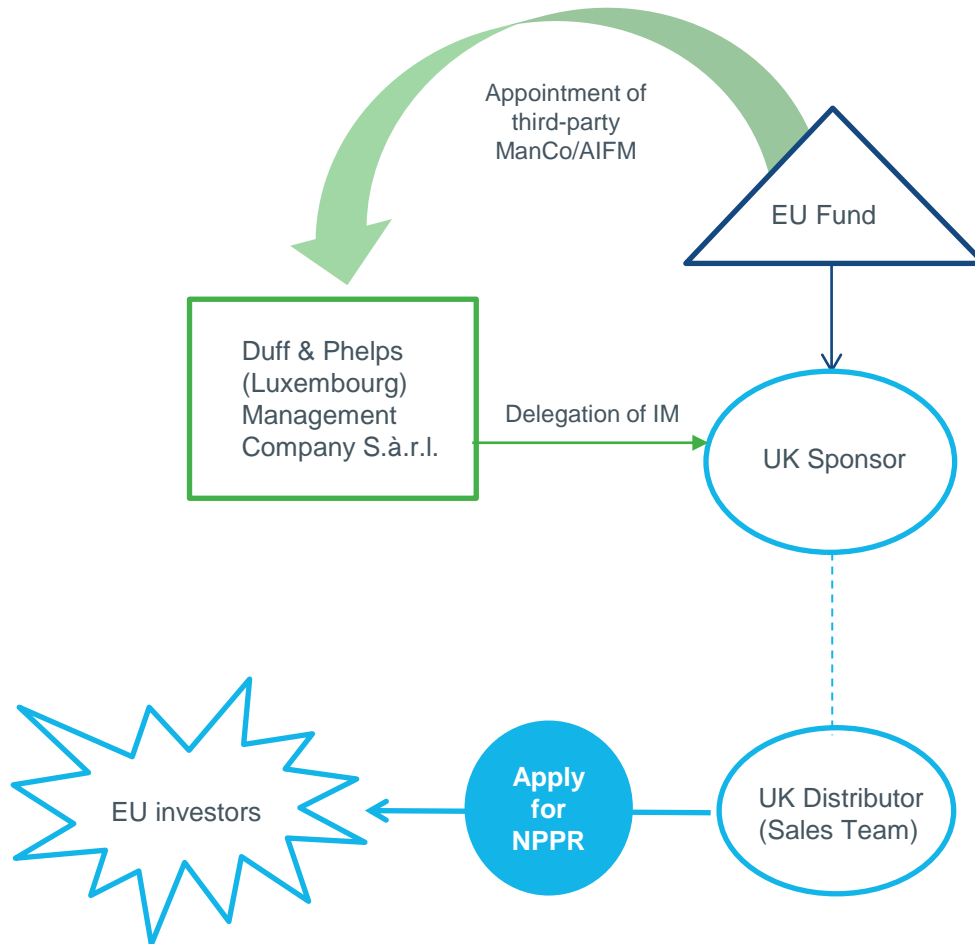
Cross-border solutions: Non-EU presence



1) GP Model

- UK individuals sitting on the board of the General Partner (GP) of a Luxembourg fund should be able to reach out to EU-based investors to market the fund.
- Would only work for the individual sitting on the board of the GP, not for the rest of the UK sales team.
- As there is no harmonized EU framework regarding self-marketing, the fund initiator should verify beforehand which jurisdictions allow the GP board members to self-market a duly passported UCITS/AIF without the GP itself being regulated to avoid a breach of regulatory restrictions.

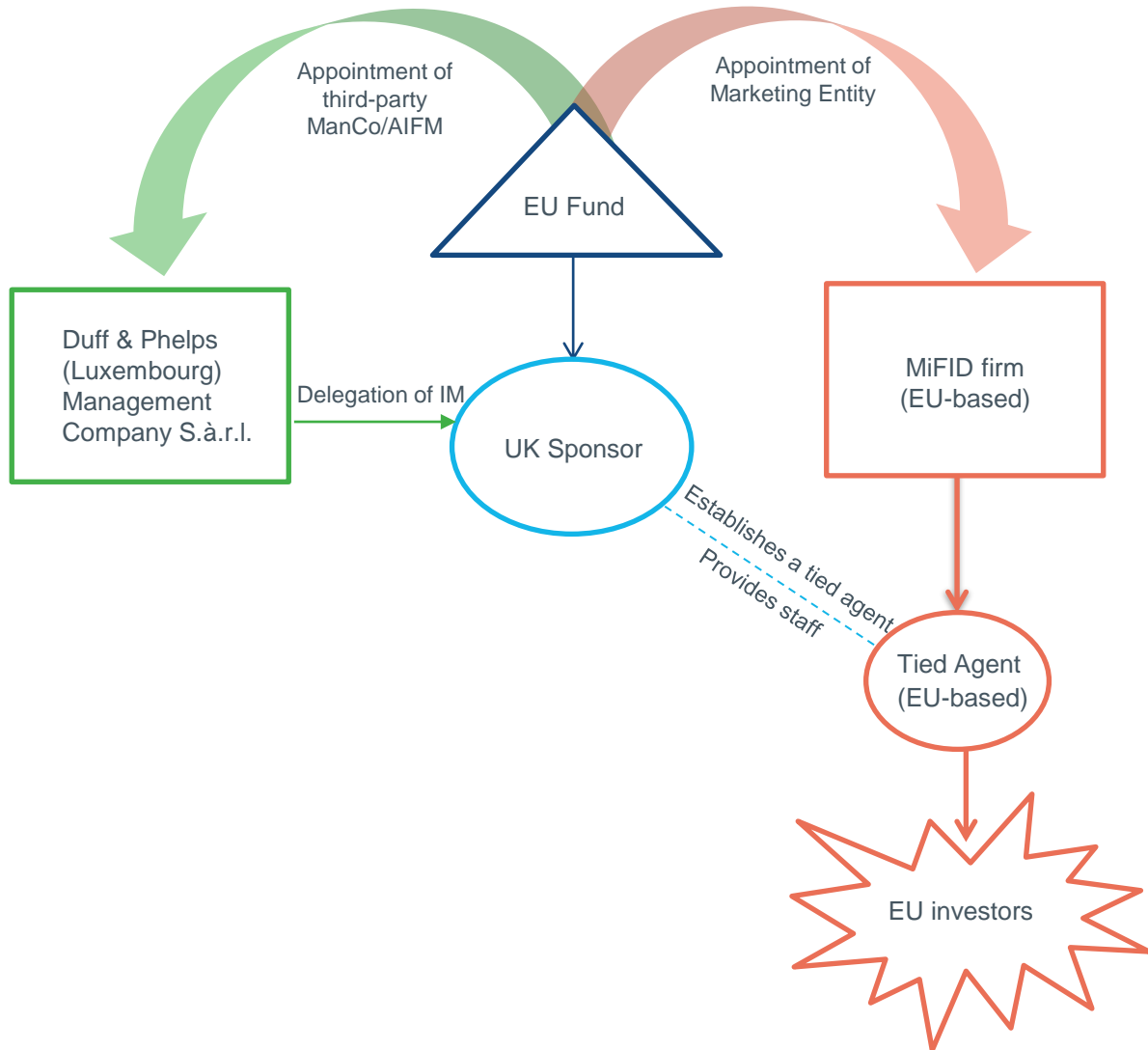
Cross-border solutions: Non-EU presence



2) NPPR

- In some EU jurisdiction, “marketing” is treated as unregulated activity, therefore there is the option to apply for NPPR to market the fund.
- In some EU jurisdictions, “marketing” is regulated activity requiring a financial services licence, which is reducing the scope of fund marketing activity that UK-based staff may conduct within certain EU countries.
- Applying for NPPR on a country-by-country basis can be a cumbersome process, time consuming and not cost-efficient if the plan is to approach a limited number of investors.

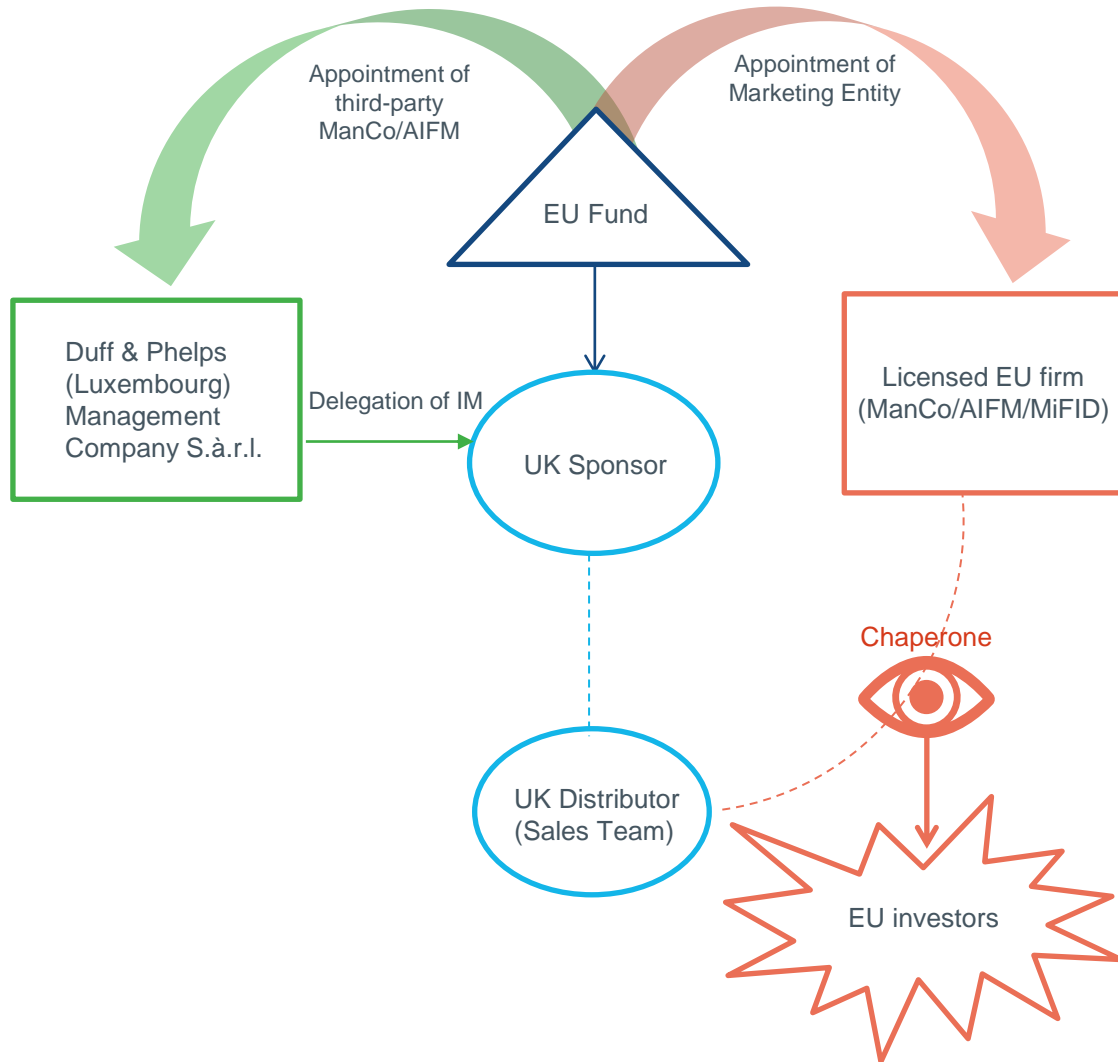
Cross-border solutions: EU presence



3) Tied Agent

- In this model, an entity of the fund sponsor is appointed as tied-agent of a MiFID investment firm, which itself is appointed by the fund to conduct marketing activities.
- The entity “acting as a tied-agent” to the relevant MiFID firm is identified in the marketing passport notifications as the marketing entity.
- The entity does not have to be regulated.
- This model is not favoured by the CSSF nor CBI. Some EU regulators are concerned about UK firms using tied agent model to bypass European rules on the distribution and that there will be unregulated individuals selling financial products in the EEA.

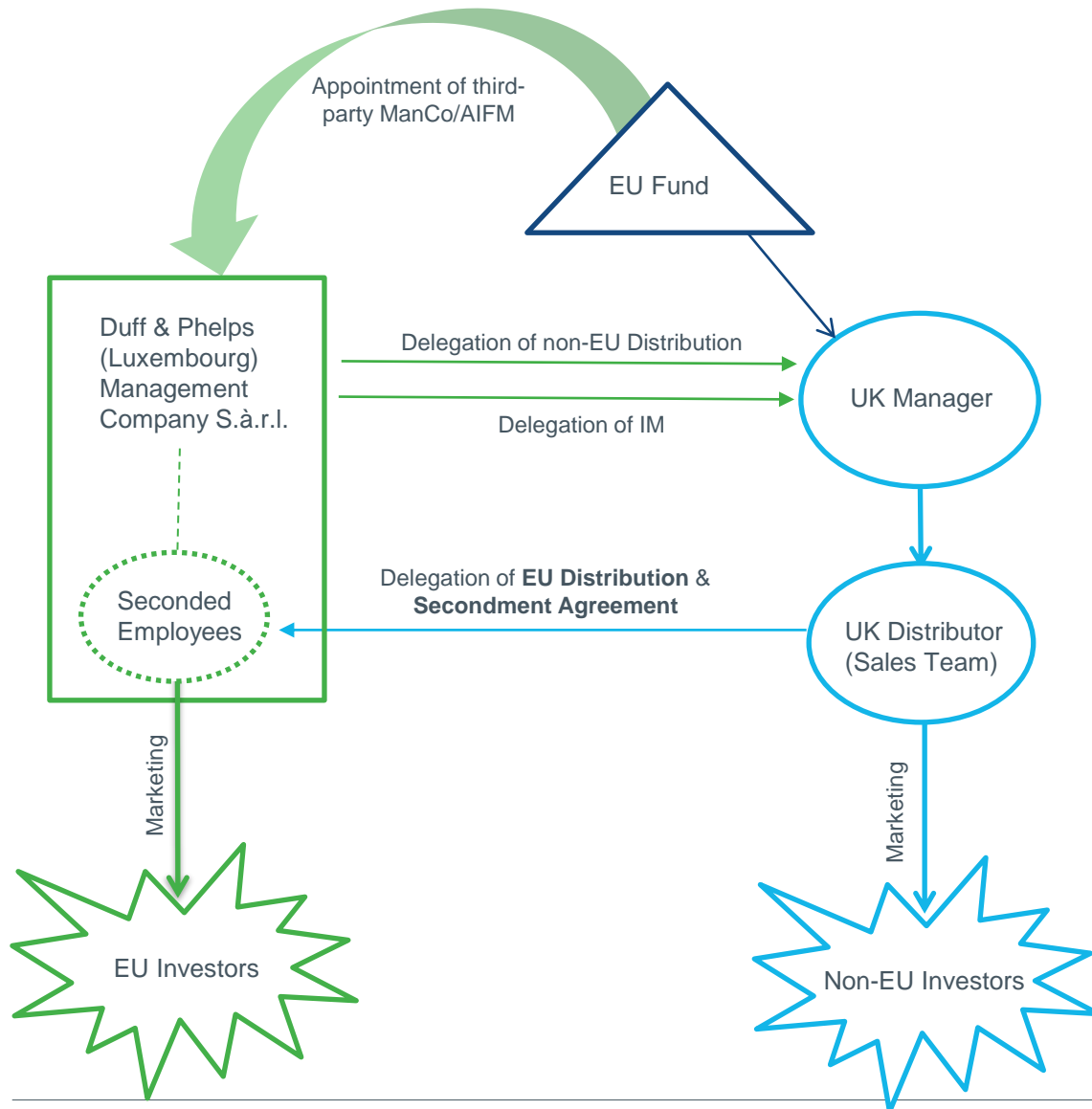
Cross-border solutions: EU presence



4) Chaperoning

- UK individual would be chaperoned by the AIFM/ManCo while attending in person meetings, phone calls with investors.
- The “chaperone” from the ManCo/AIFM must lead the meetings. And the UK individual should clarify to investors in what capacity he/she is acting i.e. as a representative of the fund’s portfolio manager for the purposes of answering questions on an information-only basis.
- Whereas this model may work for small sales teams, we do not see it working for large asset managers.
- The CSSF is not favoured to this model. However, it seems to be acceptable by the CBI.

Cross-border solutions: EU presence



5) Secondment

- Arrangement where the UK manager provides to the EU ManCo/AIFM with one or more of their staff as seconded employees.
- The nature of a secondment does not create an employer-employee relationship.
- The CSSF expressed that secondment would be under scrutiny to ensure that the secondment does not end up being purely virtual.

Secondment Model

BENEFITS

- ❖ Regulatory safety: secondment is a regulated activity in Luxembourg subject to approval by the CSSF
- ❖ Quick implementation
- ❖ UK managers can keep the same sales staff
- ❖ The ManCo/AIFM will take full responsibility of the marketing activities performed by the secondee

CHALLENGES

- ❖ Requirement of a physical presence in Luxembourg
- ❖ Secondees must use the ManCo/AIFM's telephone number, email address, laptop and business cards
- ❖ Notification process to the CSSF is yet to be standardised



05

Q & A