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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

March 21, 2012

Submitted at www.esma.europa.eu

European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris
France

Re: Discussion Paper – Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM

The National Association of Real Estate Investment Trusts ("NAREIT")[1] welcomes the opportunity to provide comments on the European Securities and Markets Authority's ("ESMA") Discussion Paper on Key concepts of the Alternative Investment Fund Managers Directive ("AIFMD") and types of AIFM.

We are broadly supportive of the approach that ESMA has taken in seeking to provide guidance on the types of AIF covered under the Directive for the purpose of their work connected with identifying the appropriate entity responsible for management (the AIFM). NAREIT has engaged with European policymakers throughout the legislative process and the beginning phases of implementation of the AIFMD – focusing particularly on the uncertain scope of the Directive.

As representatives of commercial businesses which own, develop, operate and manage real estate assets, our principal concern is that the Directive, as drafted, could arguably catch any business venture with a number of investors – whether they be direct capital investors, or shareholders of a listed company. There is no clear definition in the Directive of what is meant by "collective investment undertaking" or "fund management" to make it clear that a retail or manufacturing group, for example, is excluded from scope. While it seems quite clear that excluding such businesses is the intention, we welcome ESMA's work on precisely how that outcome is achieved as a matter of legal analysis.

[1] NAREIT®, the National Association of Real Estate Investment Trusts®, is the worldwide representative voice for REITs and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate, and finance income-producing real estate, as well as those firms and individuals who advise, study, and service those businesses.

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Our response focuses principally on these concerns – that is, drawing a clearer line between what can be considered AIF for the purpose of the Directive, and those regular operating businesses that should remain outside of the scope. In this area, we welcome ESMA's well-reasoned assessment of criteria which could help identify an AIF. We are particularly supportive of the work ESMA has undertaken in this regard around the use of a Defined Investment Policy as a criterion evidencing that a particular entity is likely to be an investment fund, rather than a commercial undertaking. This seems to be one of the most apparent, and clear, operational differentiations between a fund and business undertaking. However, the broader set of criteria, potentially with some further elaboration or additions (for instance, looking at the way an entity is valued by markets or investors; or whether the entity raises capital on public markets through the issuance of debt securities), comprise an effective set of guidelines which, taken in aggregate, will help to construct a clear view on whether the entity in question is a fund or a normal operating business.

In the following pages, we have set out more detailed response to the specific questions from this section of the Discussion Paper.

Detailed Comments
Q5. Do you agree with the orientations set out above on the content of the criteria extracted from the definition of AIF?
We broadly agree with the analysis and orientations set out in Section 4 (paras. 24-34) of the Discussion Paper. We welcome the fact that ESMA has sought to set out a number of criteria which can help regulators identify entities which should be considered AIF, and those that should not. We would agree that there is unlikely to be a single factor that would definitively identify an AIF vis-à-vis another type of business undertaking or corporation. Although not every criterion will be present in each case, when considered in aggregate, they will help to construct a clear view on whether the entity in question is a fund or a normal operating business. We particularly support the Defined Investment Policy (DIP) as a key criterion for identifying an AIF. We also agree with the characteristics listed that are likely to evidence the existence of a DIP. As such, we feel it would be particularly useful to elaborate on this principle further: using the existing wording from the definition of a holding company (exempted from the Directive under Art. 2) – a company "…the commercial purpose of which is to carry out a business strategy or strategies through its subsidiaries…" – it would be useful to draw further contrast between where a business strategy differs from a DIP (which the Discussion Paper does in para. 31). The Discussion Paper rightly points out that the guidelines set out in a DIP can be "relatively broad or narrow, but by their nature they determine more precise criteria than the ones followed by an ordinary company which simply has a 'business strategy' or in certain cases (depending on the nature of its commercial activities) an 'investment strategy'". While we agree with pointing out that the guidelines within a DIP set out the rules by which investment funds must conduct their investments in a more precise way than would be set out in a 'business strategy' that

guides a business, it would be useful to expand this contrast to other points in this paragraph, particularly:

- Whereas a DIP contractually binds a fund to follow the investment policy, as agreed with investors (subpoint 3). Conversely, a business strategy is flexible in nature – for instance, in the corporate context, the only way shareholders can override a management decision to change business strategy or investment strategy is by exercising voting rights to change the composition of the board of directors.
- Whereas a DIP will generally be fixed no later than when the investors' commitment to the fund becomes binding (subpoint 1) a fund's DIP is often fixed at the beginning of the life of a fund, and incorporated directly into the fund charter or other constitutional documents of the fund. Conversely, a business strategy (or, as noted, "investment strategy") is never formally fixed, but rather exists at the discretion of management, and is not incorporated formally into the statutory documents of a business.

The one potential identifier of a DIP set out in para. 31 to which we would disagree is the point that states, "the investment policy is clearly set out and disclosed to investors" – as this may easily blur the line between a business strategy, which is often clearly disclosed to investors in prospectuses, other company marketing materials (investment-related or otherwise), or shareholder communications. Furthermore, given the DIP is part of the contractual agreement between an investor and a fund, this additional criterion is superfluous to the overall description of a DIP in the Discussion Paper and, as such, could confuse the application of what we see as a well-reasoned and clear set of criteria.

Q6. Do you have any alternative/additional suggestions on the content of these criteria?

We believe there could be some additional criteria that could be helpful in differentiating between investment funds and ordinary business undertakings. More specifically:

Valuation approaches: Funds, whether listed or unlisted, open-ended or closed-ended, are most often valued by investors using metrics that look mainly at the assets under the funds' control, such as Net Asset Value (NAV). Even in the context of investment funds that happen to be listed/traded on major stock exchanges, the main focus of market analysis is on the "discount to NAV" at which the shares in the fund typically trade – so even here the NAV is the driver behind the valuation used by investors. By contrast, corporate and other businesses undertakings are often valued by using a combination of cash flow analysis, assets-to-liabilities ratios and growth in earnings or dividends.

Raising debt capital from public markets: While this may not be a funding source for all business undertakings, it is likely to be a helpful factor in differentiating these entities from funds, which typically do not issue unsecured publicly-offered debt on a corporate or entity basis. Generally, only corporate entities (or securitisation special purpose entities, which are explicitly not covered by the Directive under Art. 2) issue unsecured debt securities into public markets. Since the debt is unsecured, by definition the markets evaluate the debt on a business enterprise basis rather than at the asset level.

Q7. Do you agree with the orientations set out above on the notion of raising capital? If not, please provide explanations and an alternative solution.

We agree that this could be used as a potential indicator of whether an entity is likely to be considered a fund or not – however, it is unlikely to be a sole determining factor. Overall, we find the Defined Investment Policy (DIP), along with the other examples of potential criteria set out above in the answer to Q6, to be more compelling indicators.

We also believe that the link between the raising of capital and the DIP could be emphasized more, *i.e.*, in order to be a fund, the entity concerned needs not only to raise capital from investors and have a DIP, but it needs to raise that capital "with a view to investing it in accordance with" that DIP.

Q8. Do you consider that any co-investment of the manager should be taken into account when determining whether or not an entity raises capital from a number of investors?

It is difficult to formulate a reply to this question in the case of operating companies such as listed U.S. REITs because, just as with Microsoft or General Electric, such REITs do not have managers but instead employees that work for the corporate enterprise.

Q9. Do you agree with the analysis on the ownership of the underlying assets in an AIF? Do other ownership structures exist in your jurisdiction?

The Discussion Paper states "Investors in AIFs … generally … do not individually directly own the underlying assets, but rather their ownership of the assets is represented by shares/units in the AIF." This in itself is a useful distinction, and one that we feel, with further elaboration, could help to make a distinction between a fund and a business undertaking. While direct ownership of assets may not serve to differentiate between a fund and most other undertakings (as investors in any business would not be understood to directly own any underlying assets for that company) – the idea that ownership of the assets would be represented by shares or units of that AIF would seem to set AIF apart from other businesses.

The ownership of shares or units in a corporate undertaking do not usually imply any claim of ownership on the assets of that undertaking – but rather, direct equity participation in the undertaking itself. Put another way, even if the legal structure of a particular fund means that, as a matter of law, the fund investors do not in fact have an indirect ownership interest in the assets of the fund, the investors will nevertheless typically view themselves as being indirect owners of the assets (and hence seek to constrain – through the DIP – the range of assets that can be invested in). This contrasts with the position of shareholders in an ordinary business undertaking who see themselves as co-owners of the business but not of the underlying assets of the business.

Q10. Do you agree with the analysis on the absence of any investor discretion or control of the underlying assets in an AIF? If not, please explain why.
As neither investors in funds nor shareholders in business undertakings are likely to have day-to-day discretion or direct control over the assets, a more helpful measure might be whether the ownership of a share or unit allows the bearer to participate in the key decisions or overall corporate governance of the entity other than voting their ownership interests on typical corporate matters. A normal business undertaking will typically only seek shareholder approval for matters where it is required to do so by law (*e.g.*, voting on major issues such as mergers or liquidation, the election of shareholder representatives, the re-election of directors, approval of annual accounts, etc). In contrast, in the case of a fund, it is usually the case that investor consent issues are a matter for negotiation between the AIFM and the investor at the time that the AIF is launched (*e.g.*, investment in a new geography, borrowings over a certain level, extension of the investment period, etc). As set out in the response to Q9, a key trait of ownership that we believe can be helpful in distinguishing AIFs from corporate undertakings is whether those shares imply ownership of the entire undertaking, or merely the underlying assets.

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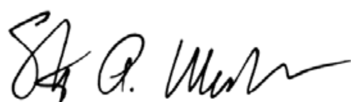
We would, of course, welcome the opportunity to discuss any of the points raised in further detail with ESMA at your request. If you should have any further comments or questions, please do not hesitate to contact us.

Respectfully submitted,



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