

Risk Management under the Alternative Investment Fund Managers Directive (“AIFMD”)

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An essential objective of the Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (“AIFM Directive”) is to ensure that all Alternative Investment Fund Managers (“AIFMs”) operate within a robust risk management framework to adequately manage risks along with the AIF’s strategies and objectives. An AIFM shall for that purpose establish adequate risk management systems (which are understood as both organisational elements – placing a central role on a permanent risk management function – as well as policies and procedures to measure and manage risks in relation to each Alternative Investment Fund (“AIF”). To that effect, an AIFM must establish and maintain a permanent risk management function and document an adequate risk management policy for the AIFs it manages. Each AIFM must also take appropriate functional arrangements to implement the risk management policy and ensure, i.a., regular reporting on risk management matters to their internal governing bodies.

The aim of this document is to provide the reader with a general overview of the main provisions of the AIFMD in relation to risk management as well as general principles for establishing a risk management function.

Considering the variety of legal and operational models available to AIFMs, there is no one size fits all approach to risk management. AIFMs should aim at tailoring their risk management systems to their own structure and the funds they manage in line with the legal framework. The AIFMD therefore also stresses in many cases the principle of proportionality taking into account the structure and complexity of the AIFM and the AIF it manages. This document should thus be read as a set of examples and principles-based guidelines, rather than prescriptive detailed rules on risk management, to help Luxembourg based AIFMs organise their risk management function.

The AIFM Directive and the Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 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 (“AIFMD-CDR”) also take into account certain provisions on risk management reflected in the UCITS directive. AIFMs may view the relevant aspects of the UCITS Directive and its implementing measures as a source of inspiration for the organisation of their risk management systems, where appropriate and proportionate¹.

¹ Further information can be found in ALFI’s risk management guidelines for Luxembourg based UCITS: “Best practice proposals for the organisation of the risk function of a UCITS management company or UCITS investment company”. The document is available on ALFI’s website.

The AIFM Directive and respective AIFMD-CDR include various provisions that address topics of relevance for an adequate risk management function. The aim of this section is to provide a brief overview of the main areas addressed.

The requirements on the risk management function as per AIFMD have to be adhered to by the AIFM as of the respective application date in line with the transitory provisions provided for in the Luxembourg law of 12 July 2013 transposing the AIFMD into Luxembourg legislation. Before that, current product specific requirements on risk management (e.g., as per SIF and SICAR law) are applicable.

As a general principle, the AIFMD-CDR includes a stringent 'no letter box entity' requirement. As such, the AIFM has to perform a substantial portion of the investment management, i.e. the two core functions portfolio management and risk management (Art. 82 (d) AIFMD-CDR).

For some AIFM structures in Luxembourg, part of the portfolio management activities may be delegated to third parties. Therefore, the provision of major tasks of the risk management process (e.g., defining risk limit systems for AIF, monitoring key risk measures, reporting and escalating risk limit breaches) by the Luxembourg based AIFM may qualify as a key aspect for providing sufficient substance at the level of the AIFM as required by AIFMD.

The risk management function² of the AIFM has to comply with fairly detailed principles as outlined within the AIFMD:

1. Permanent risk management function and its separation from operating units³ (Art. 15(1) AIFMD; Art. 39, 42, 43 AIFMD-CDR).

The articles describe the role of the permanent risk management function, i.e., to:

- Implement effective risk management policies and procedures to identify, measure, manage and monitor on an ongoing basis all relevant risks⁴;
- Ensure that the risk profile of the AIF is consistent with risk limits set, monitor risk limits⁵;
- And report to AIFM's governing body and senior management⁶.

The risk management function shall be functionally and hierarchically separated from operating units, or, at least, specific safeguards against conflicts of interest⁷ shall be implemented to allow an independent performance of risk management activities. The principle of proportionality shall be observed. In-depth analysis of the allocation of tasks and responsibilities within the AIFM pertaining to risk management is a key element of the implementation process.

²See Art. 39 AIFMD-CDR.

³See Art. 15 (1) AIFMD, Art. 14 Luxembourg AIFM Law and Art. 42 AIFMD-CDR.

⁴See Art. 39 (1) (a) AIFMD-CDR.

⁵See, Art. 15 (3) (b), (c) AIFMD, Art. 14 (3) (b), (c) Luxembourg AIFM Law and Art. 53 (3) AIFMD-CDR.

⁶See Art. 39 (d) AIFMD-CDR and Art. 60 (4-6) AIFMD-CDR.

⁷See Art. 15 (1) AIFMD, Art. 14 (1) Luxembourg AIFM Law and Art. 43 AIFMD-CDR.

II. overview of risk management areas addressed by AIFMD and AIFMD-CDR

2. Risk management systems⁸ (Art. 15 (2) AIFMD; Art. 38 - 45 AIFMD-CDR)

Appropriate risk management systems shall be implemented and, i.a., documented in the risk management policy. Risks shall be identified and assessed for each AIF managed⁹. At least the following risk categories shall be assessed (and limits (qualitative and/or quantitative) defined and monitored):

- Market risks;
- Liquidity risks;
- Credit (and counterparty) risks;
- All other risks, including operational risks, that may be material for each AIF¹⁰.

The AIFM shall periodically, at least annually, assess and review the adequacy of the risk management systems¹¹.

3. Liquidity risk management (Art. 16 AIFMD; Art. 46-49 AIFMD-CDR)

For all AIF (that are not unleveraged closed-ended) an AIFM shall implement and document appropriate liquidity management systems to monitor and manage the liquidity obligations of the AIF¹², taking into consideration both assets and liabilities (incl. investors' redemptions) of the AIF¹³.

The requirements of Art. 16 AIFMD in conjunction with Art. 46 et seq. of the AIFMD-CDR provide for a holistic liquidity framework applicable for all AIFMs, but should be adapted to the size, structure and nature of the AIFs managed by the AIFM concerned. In addition the delegated regulation specifies that the liquidity management system and procedures should allow AIFMs to apply tools and arrangements necessary to monitor illiquid assets in order to respond to redemption requests or specific market conditions. Such arrangements may include "special arrangements" such as:

- Gates and partial redemptions and suspensions;
- Temporary borrowings;
- Side pockets, lock up periods and penalties;
- Notice periods (cut off dates ahead of dealing points);
- Pools of liquid assets¹⁴.

The AIFM shall define limits and monitor adherence to them. Furthermore, the AIFM shall conduct stress tests to assess the liquidity risks of each AIF¹⁵.

⁸See Art. 38 AIFMD-CDR.

⁹See Art. 40 (1) AIFMD-CDR.

¹⁰See Art. 44 (2) AIFMD-CDR.

¹¹See Art. 15 (2) AIFMD, Art. 14 (2) Luxembourg AIFM Law and Art. 41 (1) AIFMD-CDR.

¹²See Art. 16 (1) AIFMD and Art. 15 (1) Luxembourg AIFM Law.

¹³See Art. 46 AIFMD-CDR.

¹⁴See Recital (59) AIFMD-CDR.

¹⁵See Art. 16 (1) 2nd paragraph AIFMD, and Art. 15 (1) 2nd paragraph Luxembourg AIFM Law and Art. 48 (2) AIFMD-CDR

4. Leverage (Art. 4, 15 AIFMD; Art. 6-11 AIFMD-CDR)

The AIFMD contains only a general definition of leverage. Leverage is defined as "any method by which the AIFM increases the exposure of an AIF it manages whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means"¹⁶. AIFM shall set a maximum level of leverage that an AIF can employ (including the extent of reuse of collateral)¹⁷. The leverage of an AIF shall be expressed as a ratio of the exposure of an AIF and its NAV¹⁸. The leverage shall be calculated by both the gross¹⁹ and the commitment²⁰ method. The calculation procedures shall be appropriately documented²¹.

5. Operational risk management (Art. 13 AIFMD-CDR)

In relation to the management of professional liability risks, AIFMs are required to implement effective internal operational risk management policies and procedures to identify, measure, manage and monitor appropriately operational risks including professional liability risks to which an AIFM is exposed²². Operational risks are risks of loss resulting from inadequate or failed internal processes, people and systems, or from external events, and includes legal and documentation risk and risk resulting from the trading, settlement and valuation procedures operated on behalf of

the AIF²³. Key operational risks include²⁴:

- Failure of the information technology that directly or indirectly connects the AIFM to the market;
- Risk of key persons leaving the firm;
- Failure in the investment reconciliation process performed by fund administrators and custodians;
- Fraud; and;
- Failures in trading, settlement and valuation services.

As a tool, AIFM shall set up a historical loss database to record operational failures, loss and damage experiences²⁵. The AIFM shall make use of the information within its risk management framework (i.e., use historical loss data as well as other sources of information (where appropriate, e.g., external data, scenario analysis) to assess operational risks for the AIFM).

The policies and procedures shall be well documented²⁶ and subject to regular reviews, at least annually²⁷.

The risk management function shall also provide appropriate support concerning the policies and procedures adopted for the valuation of assets²⁸.

¹⁶See Art. 4 (1) (v) AIFMD and Art. 1 (30) Luxembourg AIFM Law.

¹⁷See Art. 15 (4) AIFMD and Art. 14 (4) Luxembourg AIFM Law.

¹⁸See Art. 6 (1) AIFMD-CDR.

¹⁹See Art. 7 AIFMD-CDR.

²⁰See Art. 8 AIFMD-CDR.

²¹See Art. 6 (2) AIFMD-CDR.

²²See Art. 13 (1) AIFMD-CDR.

²³ Cf. Art. 3 No. 11 of the CSSF REGULATION NO. 10-4 TRANSPOSING COMMISSION DIRECTIVE 2010/43/EU of 1 JULY 2010 IMPLEMENTING DIRECTIVE 2009/65/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL AS REGARDS ORGANISATIONAL REQUIREMENTS, CONFLICTS OF INTEREST, CONDUCT OF BUSINESS, RISK MANAGEMENT AND CONTENT OF THE AGREEMENT BETWEEN A DEPOSITARY AND A MANAGEMENT COMPANY.

²⁴See ESMA/2011/379, page 69 § 26.

²⁵See Art. 13 (2) and (3) AIFMD-CDR.

²⁶See Art. 13 (5) AIFMD-CDR.

²⁷See Art. 13 (6) AIFMD-CDR.

²⁸See Art. 70 (3) AIFMD-CDR.

II. overview of risk management areas addressed by AIFMD and AIFMD-CDR

6. Reporting to investors and regulators (Art. 22-24 AIFMD; Art. 103-112 AIFMD-CDR)

Within the transparency requirements towards both investors and regulators, for each AIF a lot of risk relevant information is to be disclosed.

Aspects to be disclosed to investors include, e.g.:

- Description of the AIF's liquidity risk management²⁹ and any (new) arrangements for managing the liquidity of the AIF³⁰;
- Information on the risk profile of the AIF and adherence to risk limits (or additional descriptions if risk limits were exceeded)³¹;
- Information on the risk management systems employed³²;
- Changes to the maximum level of leverage as well as information on the total amount of leverage³³.

Aspects to be disclosed to regulators³⁴ include, e.g.:

- Information on the risk management systems employed;
- Information on the risk profile of the AIF (including market and liquidity risk profile);
- Information on main categories of assets in which the AIF is invested;
- Any (new) arrangement for managing liquidity of the AIF;
- Results of periodic stress tests.

²⁹See Art. 23 (1) (h) AIFMD

³⁰See Art. 23 (4) (b) AIFMD and Art. 21 (4) (b) Luxembourg AIFM Law.

³¹See Art. 23 (4) (c) AIFMD and Art. 21 (4) (c) Luxembourg AIFM Law.

³²See Art. 23 (4) (c) AIFMD and Art. 21 (4) (c) Luxembourg AIFM Law.

³³See Art. 23 (5) (a), (b) AIFMD, Art. 21 (5) (a), (b) Luxembourg AIFM Law and Art. 109 (2) AIFMD-CDR.

³⁴See Art. 24 (2) (b-e) AIFMD and Art. 22 (2) (b-e) Luxembourg AIFM Law.

III. high-level principles when implementing a risk management function

Risk management should be an integral part of an AIFM's control framework and in addition to the regulatory obligations an effective risk management function should assist the Senior Management³⁵ and the Board³⁶ in:

- Optimising growth without exposing the organisation to undue risk;
- Demonstrating due diligence in daily management;
- Promoting proactive management and early identification of risk;
- Increasing accountability and responsibility in the organisation.

The management of risks is everyone's responsibility and needs to be enforced from the top of the organisation. A culture of risk awareness and risk management within an organisation is essential for a risk management system to be effective.

The Board is therefore ultimately responsible for ensuring that the AIFM effectively manages its risks, the risks in the funds which it manages and that it has policies and procedures in place to measure and manage those risks. It shall furthermore provide for a clear allocation of roles and responsibilities concerning risk management tasks and related actions.

The Senior Management is in charge of the day-to-day management of the business matters of the AIFM. In this role, the managers (similar to the 'dirigeants' or 'conducting officers' in the UCITS management companies) will be either (i) directly conducting the risk management as risk managers in the risk management function or (ii) will be in charge of the oversight of the risk management function.

In both cases the senior management will jointly be responsible for the ongoing measurement and management of the AIF risks. The escalation procedures will encompass senior management as a primary escalation level and the Commission de Surveillance du Secteur Financier (CSSF) will consider the managers as its primary contact for all AIFM matters, including risk management.

The organisation of Senior Management could be subject to the proportionality principle. At least two of the managers should, in principle, work in Luxembourg. Having regard to the nature, scale and complexity of the activities of the AIFM, the CSSF may nevertheless agree, through a duly supported request for derogation made in advance, that for example only one of the manager of the AIFM shall work in Luxembourg.

A risk management function should be able to perform its role separately from operating units (subject to the principle of proportionality). This shall allow the persons responsible for risk management to interact freely with all areas of the AIFM for the purpose of identifying and escalating risk issues or control gaps. Appropriate safeguards against conflicts of interest shall be implemented allowing for the independent performance of risk management activities. Its resources should be commensurate with the size of the institution, and the nature and complexity of its activities. The staff executing the function has to have appropriate expertise and knowledge of the AIFM's business generally and of the AIFs that the AIFM manages directly or through delegates.

³⁵See Art. 1 (3) AIFMD-CDR: " 'senior management' means the person or persons who effectively conduct the business of an AIFM in accordance with Article 8(1)(c) of Directive 2011/61/EU and, as the case may be, the executive member or members of the governing body;"

³⁶See Art. 1 (4) AIFMD-CDR. For Luxembourg based AIFM, the term "governing body" refers to the Board of Directors of the AIFM (externally managed structures) or the AIF itself (internally managed). In this document, the term "Board" or "Board of Directors" is used to refer to the governing body of the AIFM.

III. high-level principles when implementing a risk management function

If the performance of the risk management function is delegated to a third party, the external firm must have access to all relevant information and report to the Senior Management. However, also in case of a delegation, the AIFM retains full responsibility for the effective and appropriate execution and monitoring of risk management. The AIFM should also be aware that the possibility to delegate may be limited following the “no letter box” provisions under AIFMD. The entity providing the delegated service must have sufficient technical and professional expertise to execute the function. The delegation should be assessed regularly to ensure proper and effective supervision of the delegation function and to thus compliance with Board/Senior Management’s overall responsibilities.

Additionally, AIFMs may receive specific risk management services from other areas of expertise (either from group or external parties). These services are often purely technical and system related matters (i.e. centralised risk measurement system) and by such to be considered as technology outsourcing or risk management support services. The AIFM remains ultimately in charge and responsible for the interpretation of results and related provision of transparency to the governing bodies. Examples of services rendered to the AIFM and its risk management function may include, e.g., provision of risk management calculations, additional risk relevant data (incl. portfolio information), IT risk management tools or other risk relevant inputs such as expert opinions. The risk management function will be responsible for coordinating the receipt of services (whilst assuring sufficient oversight and quality) to adequately perform the risk management processes.

AIFMs intending to operate on a risk management servicing model or to delegate the risk management function are encouraged to consider the paper produced by the ALFI Technical Committee on delegation/outsourcing of risk management by UCITS and their management companies (“Guidelines for the risk monitoring of functions outsourced/delegated by a management company or investment company”) available on ALFI’s website.

1. Governance and organisation of RM

1.1. Basic risk management structures

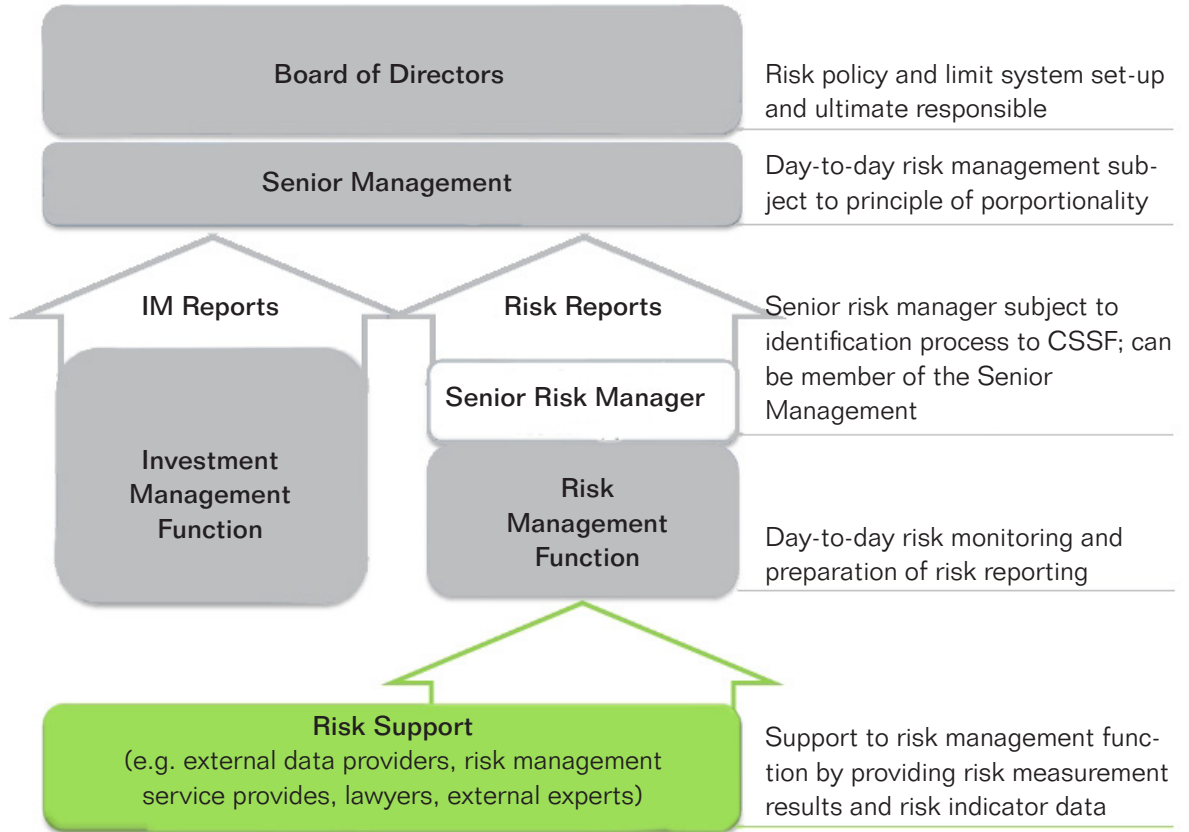
It concludes from the variety of existing organisational and governance models of AIFM that also risk management governance structures may vary. Each AIFM will have to decide on how to best set-up a risk management function within its given operating model.

This could either include, according to the above introductory notes, a separate and fully staffed risk management team within the AIFM, delegating the risk management activities to a third party (whereby considerations should be given to the “letter box entity” provisions) or other organisational models (e.g., Board/Senior Management to oversee and perform required risk management tasks). However, according to proportionality principles it is also possible that, where the organisation permits, a senior manager can be appointed to assume and oversee the risk management function; however, also in such cases the Board/Senior Management remains responsible and should therefore ensure to monitor, inter alia, overall compliance with risk management requirements and its organisation.

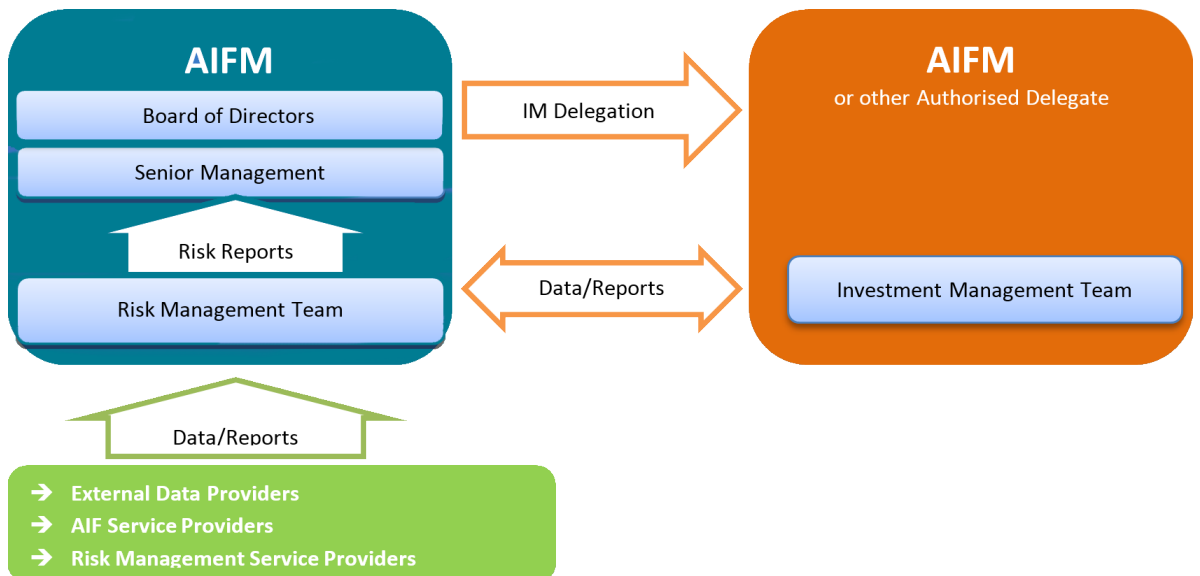
It should be highlighted that the principle of proportionality shall and can be taken into consideration for the organisational aspects of a functionally and hierarchically separated risk management function. However, in any case, the AIFM’s Board/Senior Management will have to ensure that, whatever the chosen organisational structures may be, a clear allocation of tasks and responsibilities pertaining to risk management is made.

To better explain the above, please refer to the below basic structures as examples for risk management structures:

Integrated Structure with Senior Risk Manager

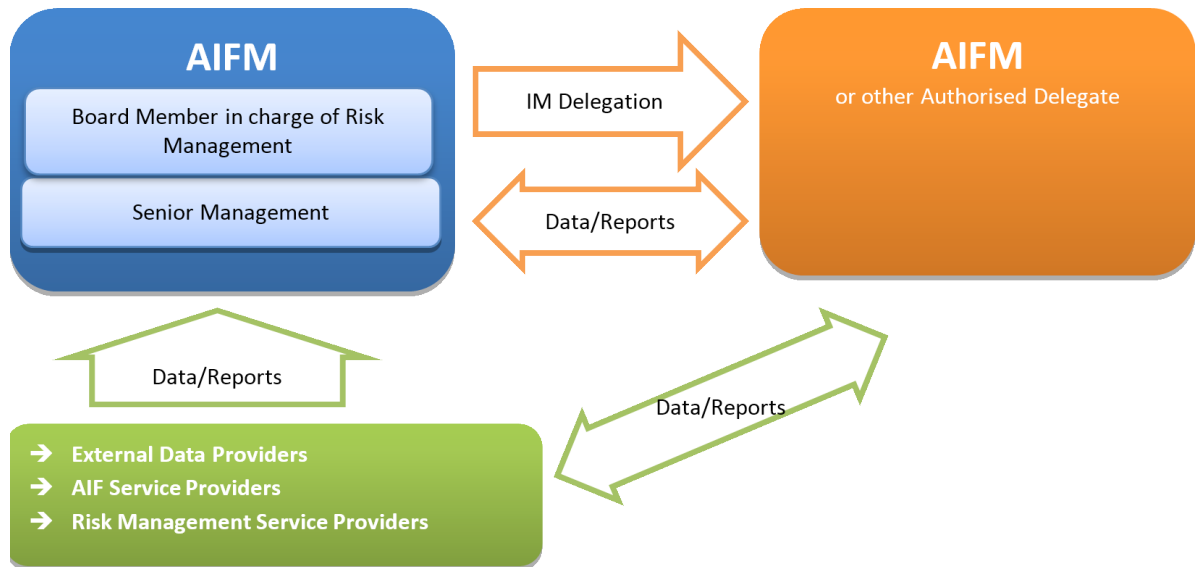


AIFM with investment management delegation and fully staffed internal risk management function



III. high-level principles when implementing a risk management function

AIFM with investment management delegation (vice versa if risk management is delegated)

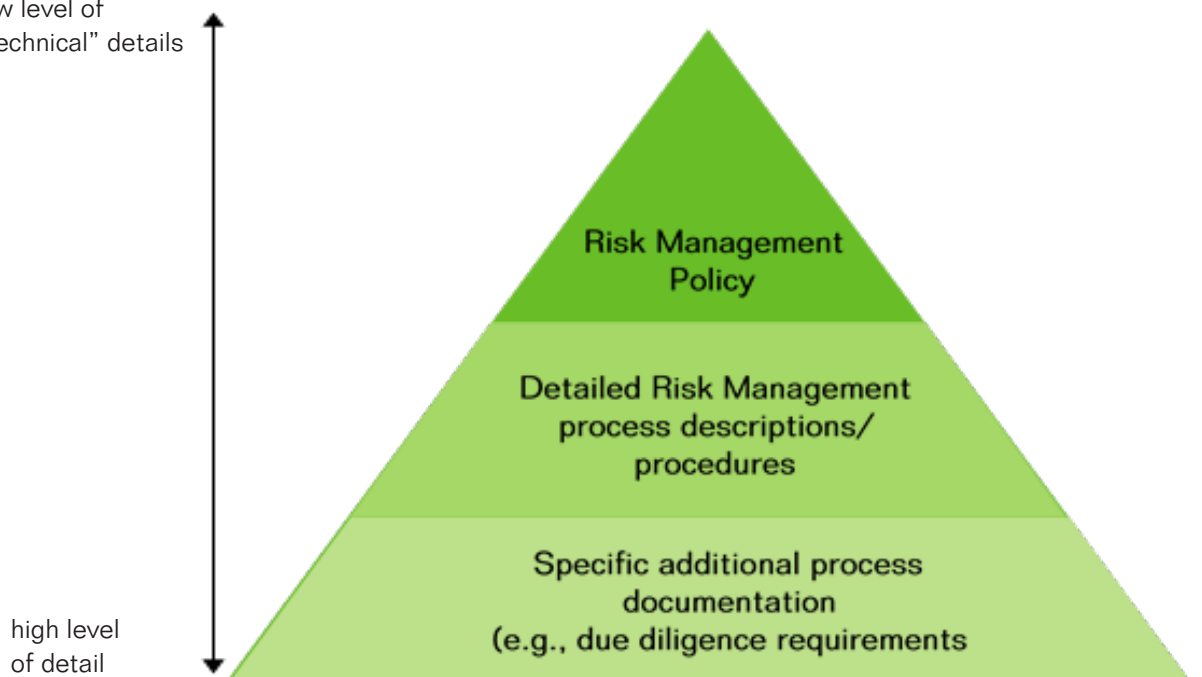


1.2 Risk management policy, procedures and process descriptions

Having agreed an appropriate risk management organisational structure - aligned with the overall AIFM risk framework - the risk management function will, in accordance with AIFMD requirements,

have to document relevant risk management tools and arrangements as well as the governance structure of the risk management systems within its risk management policy.

low level of "technical" details



Roles and responsibilities pertaining to risk management as well as risk tools and arrangements to ensure measurement, management and reporting of risks will have to be documented in the risk management policy. The AIFMD, likewise to UCITS IV, places emphasis on the role of the Board/Senior Management in overseeing the implemented risk management systems and to regularly review and approve the Risk Management policy. The risk management function shall have a holistic view on the risks an AIF is exposed to as the AIFM Directive defines a broad scope for risk management.

Further detailed risk procedures and/or specific risk management process documentation (or related documents) may be complementing the risk management policy. Other specific process documentation (that may not be under the responsibility of the risk management function) that are important for managing risks relevant for an AIFs investment strategy (e.g., description of due diligence process and requirements) may complete the documentation ensuring adequate risk management systems of the AIFM.

2. Identification of risks

The risk management function shall implement adequate arrangements, processes and techniques to identify for each AIF it manages material risk categories to which the AIF are or might be exposed to.

One may ask the following, non-exhaustive questions:

- How do we identify potential risks within the AIFM and the funds managed? (Identification);
- How do we know if these risks exist within our business? (Identification);
- If they exist how do we know if they represent a significant risk? (Measurement);
- Is the risk exposure and/or potential loss acceptable to the AIFM? (Measurement and Management).

Based on the AIFMD, risk limits (quantitative or qualitative) shall at least be set (and thus risks have also to be identified) for the following categories of risks:

- Market risks (such as, e.g., changes in economic situation (such as, e.g. interest rate shifts, price volatility);
- Credit risks (such as, e.g., issuer/concentration risks, risk of deterioration of credit spreads);
- Counterparty risks (such as, e.g., counterparty default risks);
- Liquidity risks (such as, e.g., inability to provide liquidity to investors, inability of fund to pay liabilities, inability of fund to pay margin requests);
- Operational risks (such as, e.g., failure in NAV calculation process, failure in settlements).

Each AIFM will have to identify on an on-going basis the specific risks to be covered within the risk management policy, based on the nature, scale and complexity of its business and the risk profiles and strategies of the funds it manages. There is thus no one-size-fits all approach towards risk categories for an AIFM (please refer to the graph under point 2.3 for an exemplary overview of potential risk categories).

3. Measurement and management of risks

Having identified and documented the applicable risks, the risk management function needs to define the means/tools to measure and manage those risks.

The following needs to be considered:

- Determine the relevant measurement/control method implemented for the risk categories identified [Measurement]?;
- Document the approach to limitation of risks (e.g., quantitative/qualitative limit criteria) and determine the required frequency of monitoring [Monitoring];
- Determine the process for reporting and for escalation in case of limit breaches [Management].

III. high-level principles when implementing a risk management function

When looking into the risks for each AIF, the risk management function will define respective measurement approaches and limits for portfolio related risk categories based on an analysis of the risk profile of the fund, i.e., based on the AIF characteristics that are detailed in the investment principles as outlined in the fund documentation.

The risk management function will have to determine which tools to apply to best measure and monitor the relevant risks identified. To manage the risks identified, for each risk category qualitative or quantitative risk limits will have to be set.

As mentioned before, further details on the requirements for liquidity risk management as well as on the calculation and limit setting for the leverage of an AIF are defined in the AIFMD.

The risk management function will be responsible for the collection of risk information (from various stakeholders of an AIF as the case may be) and the meaningful presentation to the Board/Senior Management.

A practical template which can be used to provide to the Board/Senior Management an overview as to whether each relevant risk is properly addressed is given in the matrix below.

Examples on identification, measurement and management of risks							
Risk category identified	Assets concerned	Description of measures/controls	Quantitative/qualitative approach	Approach to limitation of risks	Frequency of measurement	Reporting/ Escalation	Owner/ Controller
Examples							
Market risk							
Credit risk							
Liquidity risk							
Transaction risk							
Valuation risk							
Operational risk							
Other risk							
(...)							

Similar to the provisions regarding UCITS, the AIFMD sets up rules regarding the use of leverage. An AIFM applying for authorisation which intends to manage AIFs using leverage must disclose its policies as regards such use of leverage to the CSSF (Article 7 (3) a) AIFMD).

Section 2 of the AIFMD-CDR³⁷ as well as its annexes I and II contain calculation rules regarding leverage and require two methods to calculate leverage, the gross method (in accordance with the rules set out in Article 7 of the Level-II-Regulation) and the commitment method (in accordance with the rules set out in Article 8 of the Level-II-Regulation). In relation to the commitment method, the conversion methods for derivatives are similar to those applicable to UCITS as set out in the CESR/ESMA Guidelines 10-788 dated 28 July 2010.

With respect to the risk management, AIFMs have to set a maximum level of leverage for each AIF they manage as well as the right to reuse collateral or guarantee, taking into account amongst other the type, the investment strategy and the sources of leverage of the AIF (Article 15 (4) AIFMD). The maximum leverage level for an AIF can be set in reference to the gross and the commitment calculation approach for leverage.

The circumstances in which the AIF may use leverage, the types and sources of leverage and the associated risks, any restrictions on the use of leverage and any collateral and reuse arrangements as well as the maximum level of leverage must also be disclosed to the investors, but also on a regular basis any changes to the maximum level of leverage as well as any right of the reuse of collateral or any guarantee granted under the leveraging arrangement and the total amount of leverage employed by each AIF (Article 23 (1) and (5) AIFMD).

Information about the overall level of leverage employed by each AIF and a breakdown between leverage arising from borrowing or cash or securities and leverage embedded in financial derivatives as well as information about the extent to which the AIF's assets have been reused under leveraging arrangements must be made available to the CSSF. This shall include the identity of the five largest sources of borrowed cash or securities for each AIF and the amounts of leverage received from each of those sources (Article 24 (4) AIFMD).

4. Reporting of risks and related information

Risk reporting is a crucial part of risk management. The below section aims for giving an overview of key aspects in relation to risk reporting – in particular one needs to consider risk reporting in light of its different recipients:

- Internal risk reports to the governing bodies of an AIFM/AIF;
- external risk management information to:
 - regulators;
 - investors.

4.1. Reporting to the Board/Senior Management

Adequate risk reporting is an integral part for a risk management function and in particular for the Board/Senior Management to ensure they can comply with their obligations and responsibilities of oversight. In order to ensure that the risk management function obtains the necessary information from other functions and/or service providers, a structured bottom up reporting is needed. Based on the information received and the analysis performed by the risk management function and other functions, a meaningful reporting to the Board/Senior Management is key to making risks transparent as well to propose and finally decide on mitigating measures.

³⁷Art. 6 to Art. 11 AIFMD-CDR.

III. high-level principles when implementing a risk management function

The content and frequency of risk reporting to the Board/Senior Management depends on the nature, scale and complexity of the AIFM and the funds it manages. There is no standard either on the content or on the frequency of a reporting which fits to all AIFMs equally.

The frequency of periodical reporting of the risk management function including the possibility of ad hoc reports (e.g., on significant risk issues noted), should be described in the risk management policy. Reporting should be in a standard format, as defined in the risk management policy, that includes information on all risk categories identified and laid down in that policy.

Attached is an example on how a risk management policy may define a written principle on risk reporting:

- The Board/Senior Management will receive a holistic report on all relevant risk types. This report will be based on the data gathered bottom up by the risk management function;
- The risk management function is responsible for ensuring receipt of necessary bottom up reports from relevant stakeholders (e.g., other functions, service provider) and that reports are received timely, are accurate and consistent;
- The person responsible for risk management will report at least quarterly to the Board/Senior Management;
- The person responsible for risk management will ensure that risk reports are holistic (considering all risk categories identified), timely and accurate;
- The risk reports will give info on current/new risks including a statement on its level (e.g. low, medium, high) and its evolution over time and measures to mitigate existing risks where possible;
- The risk reports shall provide the Board/Senior Management with all necessary information to decide on appropriate measures to be taken to control and mitigate all relevant risks;

- The person responsible for risk management must ensure that any relevant new high risk issues will be reported on an ad hoc basis to the Board/Senior Management.

4.2 Reporting to Regulators

The AIFMD requires an AIFM to provide on a regular basis information on the AIF it manages to the competent authorities. In addition to the AIFM directive the AIFMD-CDR provides further guidance on transparency requirements incl. risk management related information provided to the governing bodies of an AIFM/AIF, the regulators and the investors.

This section intends to give an overview of key risk reports/information that needs to be provided to regulators. Particular reference is made to Articles 110 and 111 of the AIFMD-CDR³⁸ that establish the content, format and frequency of information to be provided to the regulators.

Annex IV of the AIFMD-CDR includes the pro-forma reporting templates that shall be used to provide the required information. Additional details on the information to be provided have been specified in the Final report on reporting obligations published by the ESMA³⁹.

The following is a summary of key risk management related information that an AIFM shall provide to the regulator of the AIFM's home Member State (we are referring here directly to the risk profile section of reporting template provided by the ESMA⁴⁰):

- Market risk measures: Net equity delta, CS01, DV01, other measures (if requested by the national competent authority);
- Counterparty risk profile: Estimated percentage of securities traded via regulated exchange/OTC, Estimated percentage of derivatives transactions cleared by CCP/Bilaterally/Tri-party, Value of collateral posted to all counterparties;

³⁸Referencing to Art. 24(1) and Art. 3(3) d), Art. 15 (3) b), Art. 16 (1), Art. 24 (2), Art. 24 (4).

³⁹ Please refer also to ESMA Final Report "Guidelines on reporting obligations under Articles 3(3) (d) and 24(1), (2) and (4) of the AIFMD (revised)" published on 15. November 2013 ("ESMA/2013/1339 revised").

⁴⁰ 2013-1359_Consolidated_aifmd_reporting_template_v1.1_revised.xlsx – sheet "AIF file 24(2)"

- Liquidity risk: Percentage of portfolio capable of being liquidated within defined periods, percentage of investor equity that can be redeemed within defined periods;
- Stress tests: Main results of stress tests (market risk, liquidity risk);
- Leverage: Leverage levels measured using both gross and net approach.

Also, even though other sections of the reporting are not formally identified as being related to risk measures, they might be populated by the Risk Manager or his team (i.e. geographical concentrations, principal exposures ...).

Frequency:

- For AIFMs with AuM⁴¹ between EUR 100 million or EUR 500 million⁴² but < EUR 1 billion
 - on a half-yearly basis;
- For AIFMs with AuM in total exceeding EUR 1 billion
 - on a quarterly basis;
- For each AIFs with a level of AUM above EUR 500 million when the total level of AUM at the level of the AIFM is below EUR 1 billion
 - on a quarterly basis;
- For AIFMs in respect of each unleveraged AIF under their management which, in accordance with its core investment policy, invests in non-listed companies and issuers in order to acquire control
 - on an annual basis;

Additional information for AIFMs which are managing AIFs that are leveraged on a “substantial basis”

All AIFMs who manage AIF that make use of leverage on a “substantial basis” (i.e., leverage (based on commitment calculation) >3 times the NAV of the AIF) need to report to the regulators additional information as per Article 24(4) of the AIFMD. The reporting frequency of such information will be aligned with the frequencies defined here above.

All information shall be provided by using the templates provided by the ESMA (2013-1359_Consolidated_aifmd_reporting_template_v1.1_revised.xlsx – sheet “AIF file 24(2)”) and be sent in an XML format.

4.3 Reporting to Investors

This section intends to give an overview of key risk reports/information that needs to be periodically/regularly provided to the investors. Particular reference is made to Articles 108 and 109 of the AIFMD-CDR⁴³ that establish the content, format and frequency of periodical and regular information to be provided to the investors.

The required content concerning periodically information to investors may also be included in the annual report of the AIF. Actually, if the addition of the information provided in the prospectus and in the financial statements is not sufficient to cover all the requirements defined by the regulator regarding the reporting to investors, then either the financial statements or the prospectus will need to be upgraded or, a third document will need to be created by the AIFM.

The following is a summary of key risk management related information that an AIFM shall provide to the investors of the AIF:

Regular / periodic reporting to investors:

A. Disclosure of the risk profile of the AIF (Art. 108 (4) AIFMD-CDR)

Outline of:

- Measures to assess the sensitivity of the AIF’s portfolio to the most relevant risks to which the AIF is or could be exposed;
- If risk limits set by the AIFM have been or are likely to be exceeded (if exceeded a description of the circumstances and the remedial measures taken).

⁴¹ Calculated in accordance with Article 2 of the CDR

⁴² The two different thresholds being linked to leverage and close-end criteria

⁴³ Referencing to Art. 23 (4) and (5) AIFMD.

III. high-level principles when implementing a risk management function

B. Information on the risk management systems (Art. 108 (5) AIFMD-CDR)

Main features of the risk management systems employed by the AIFM to manage the risks to which each AIF is or may be exposed to.

C. Information on arrangements for liquidity management (Art. 108 (2) and (3) AIFMD-CDR)

- Assets that are subject to special arrangements;
- Any new arrangements for managing the liquidity of an AIF (e.g., immediate notification in case gates are activated, etc.).

D. Information on leverage (Art. 109 (2) and (3) AIFMD-CDR)

- Information on changes to the maximum level of leverage calculated in accordance with the gross and commitment methods;
- Information on the total amount of leverage calculated in accordance with the gross and commitment methods:

Frequency:

AIFMs shall for each of the EU AIFs that they manage and for each of the AIFs that they market in the Union make available to AIF investors the information mentioned here above before investments⁴⁴.

⁴⁴ Article 23 of the Directive



The Association of the Luxembourg Fund Industry (ALFI), the representative body for the Luxembourg investment fund community, was founded in 1988. Today it represents more than 1 300 Luxembourg-domiciled investment funds, asset management companies and a wide variety of service providers including depository banks, fund administrators, transfer agents, distributors, law firms, consultants, tax advisers, auditors and accountants, specialist IT providers and communications agencies.

Luxembourg is the largest fund domicile in Europe and its investment fund industry is a worldwide leader in cross-border fund distribution. Luxembourg-domiciled investment structures are distributed in more than 50 countries around the globe, with a particular focus on Europe, Asia, Latin America and the Middle East.

ALFI defines its mission as to “Lead industry efforts to make Luxembourg the most attractive international centre”.

Its main objectives are to:

Help members capitalise on industry trends

ALFI’s many technical committees and working groups constantly review and analyse developments worldwide, as well as legal and regulatory changes in Luxembourg, the EU and beyond, to identify threats and opportunities for the Luxembourg fund industry.

Shape regulation

An up-to-date, innovative legal and fiscal environment is critical to defend and improve Luxembourg’s competitive position as a centre for the domiciliation, administration and distribution of investment funds. Strong relationships with regulatory authorities, the government and the legislative body enable ALFI to make an effective contribution to decision-making through relevant input for changes to the regulatory framework, implementation of European directives and regulation of new products or services.

Foster dedication to professional standards, integrity and quality

Investor trust is essential for success in collective investment services and ALFI thus does all it can to promote high professional standards, quality products and services, and integrity. Action in this area includes organising training at all levels, defining codes of conduct, transparency and good corporate governance, and supporting initiatives to combat money laundering.

Promote the Luxembourg investment fund industry

ALFI actively promotes the Luxembourg investment fund industry, its products and its services. It represents the sector in financial and in economic missions organised by the Luxembourg government around the world and takes an active part in meetings of the global fund industry.

ALFI is an active member of the European Fund and Asset Management Association, of the European Federation for Retirement and of the International Investment Funds Association.

To keep up to date with all the news from the association and the fund industry in Luxembourg, join us on [LinkedIn](#) (The Luxembourg Fund Industry Group by ALFI), [Twitter](#) (@ALFI-funds), [Youtube](#), [Vimeo](#) or visit our website at www.alfi.lu.



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