

The rock of Sisyphus

Facing the burden of regulation



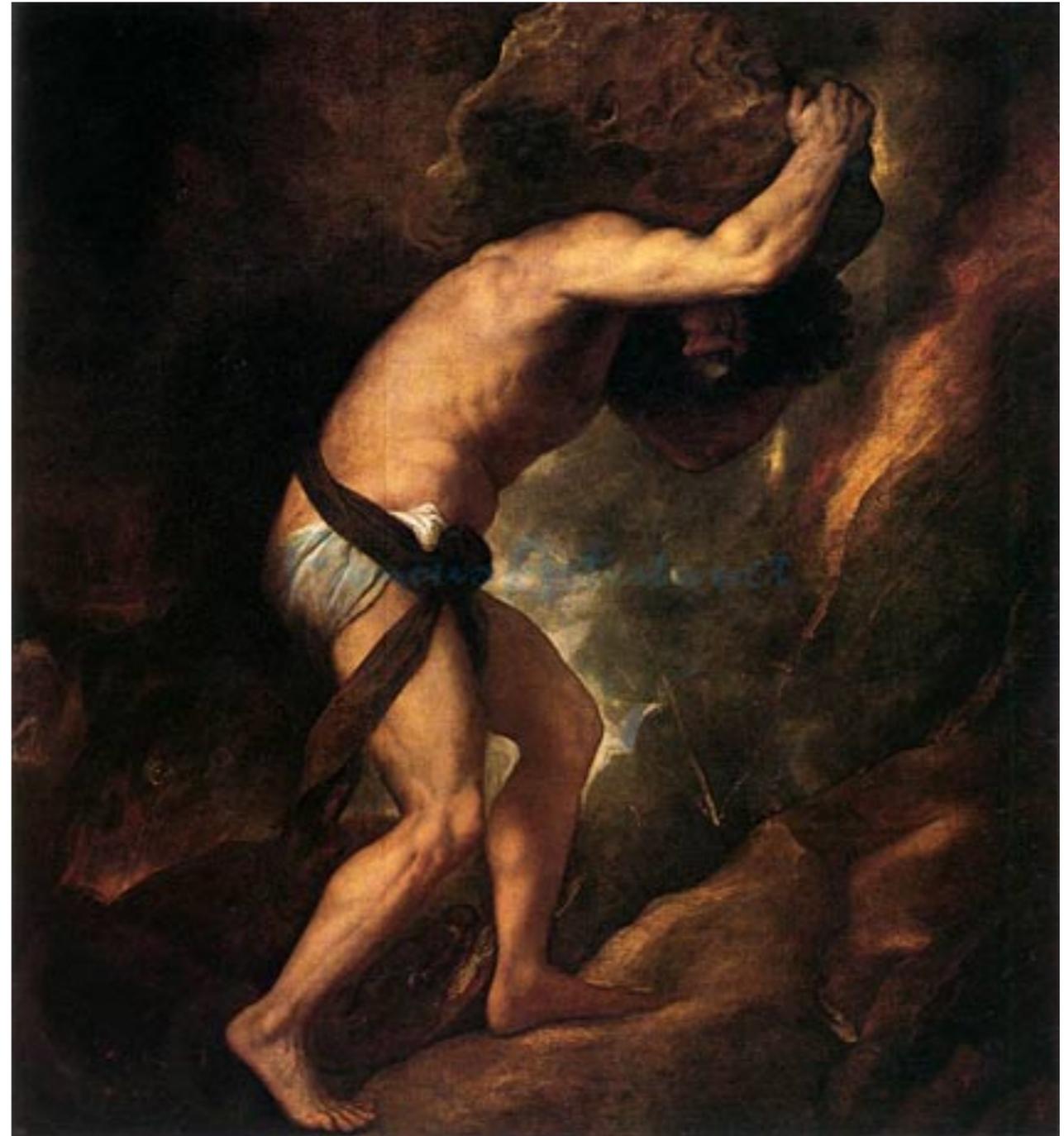
Presentation to the Real Estate Investors' Forum
18th September 2013

John Forbes
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CONSULTING LLP



The burden of regulation

- AIFMD
- Dodd Frank
- FATCA
- Solvency II and IORP

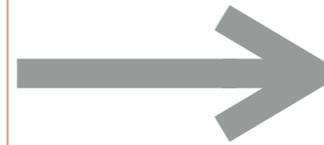
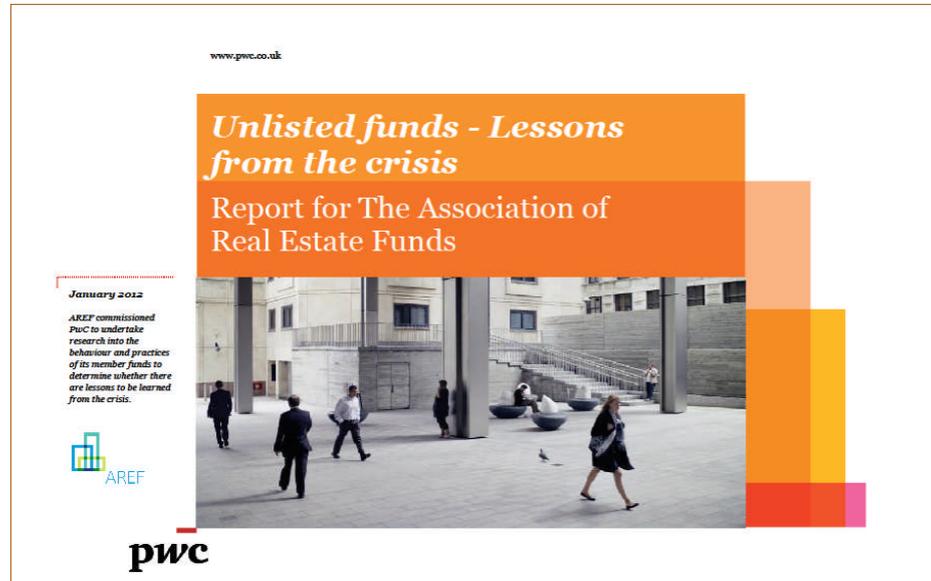


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A changed environment for the industry

Investor pressure



Improved governance
Greater transparency
Stronger controls environment
More independent supervision



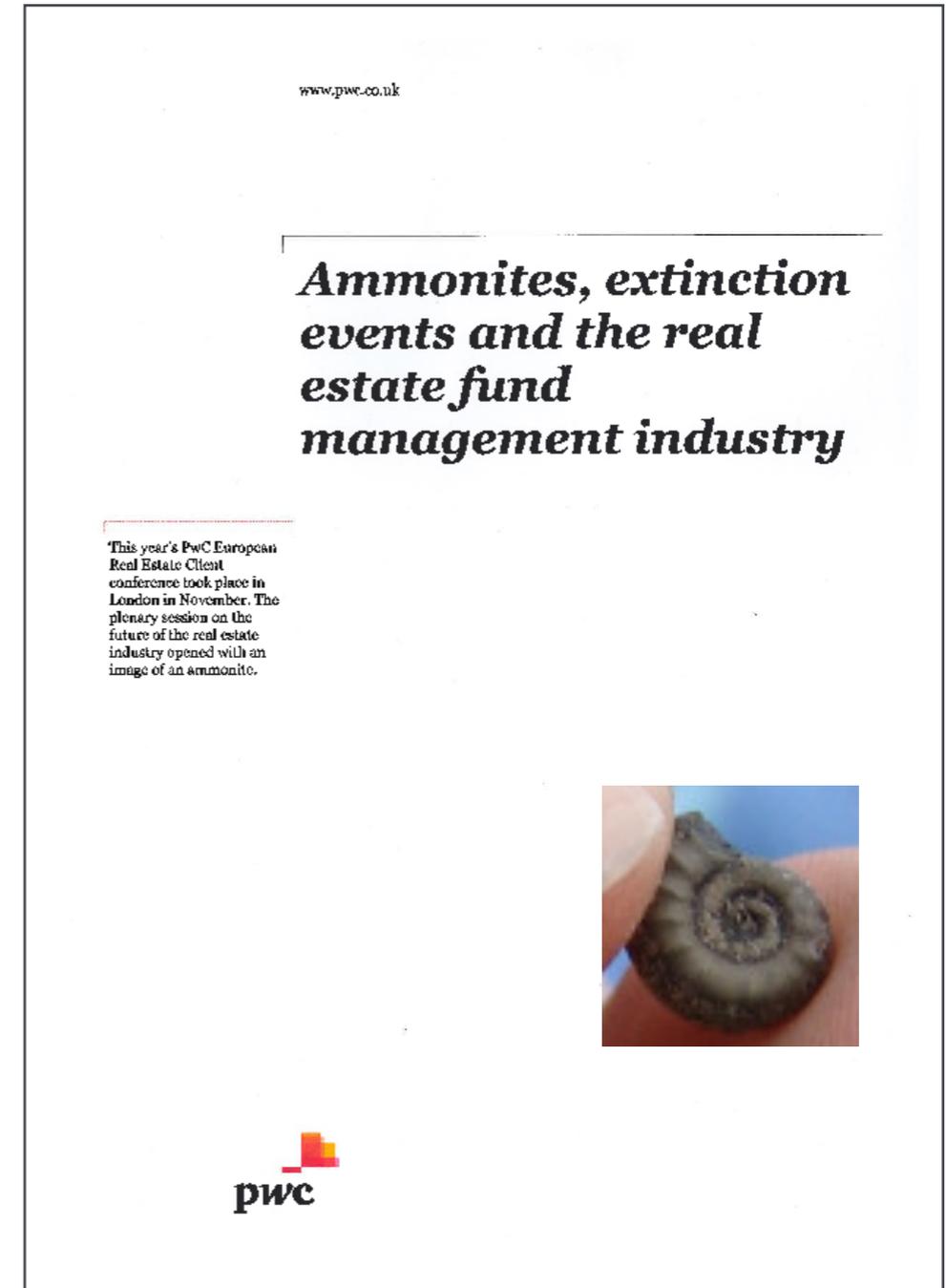
Regulatory pressure

DIRECTIVE 2011/61/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
of 8 June 2011
on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC



Ammonites, extinction events and the real estate fund management industry

This was a report looking at the regulatory and other pressures expected to be a driver for consolidation in the real estate investment management industry. The paper was written in the Autumn of 2010 and was updated in the Autumn of 2012.



The view in Autumn 2010 when the report was published.



Existing funds reach maturity
Investors search for reassurance

Accounting for leases
Accounting for greenness

Real estate investment management becomes regulated – AIFMD and Dodd Frank

Death throes of defined benefit pensions
Life insurance prepares for Solvency II

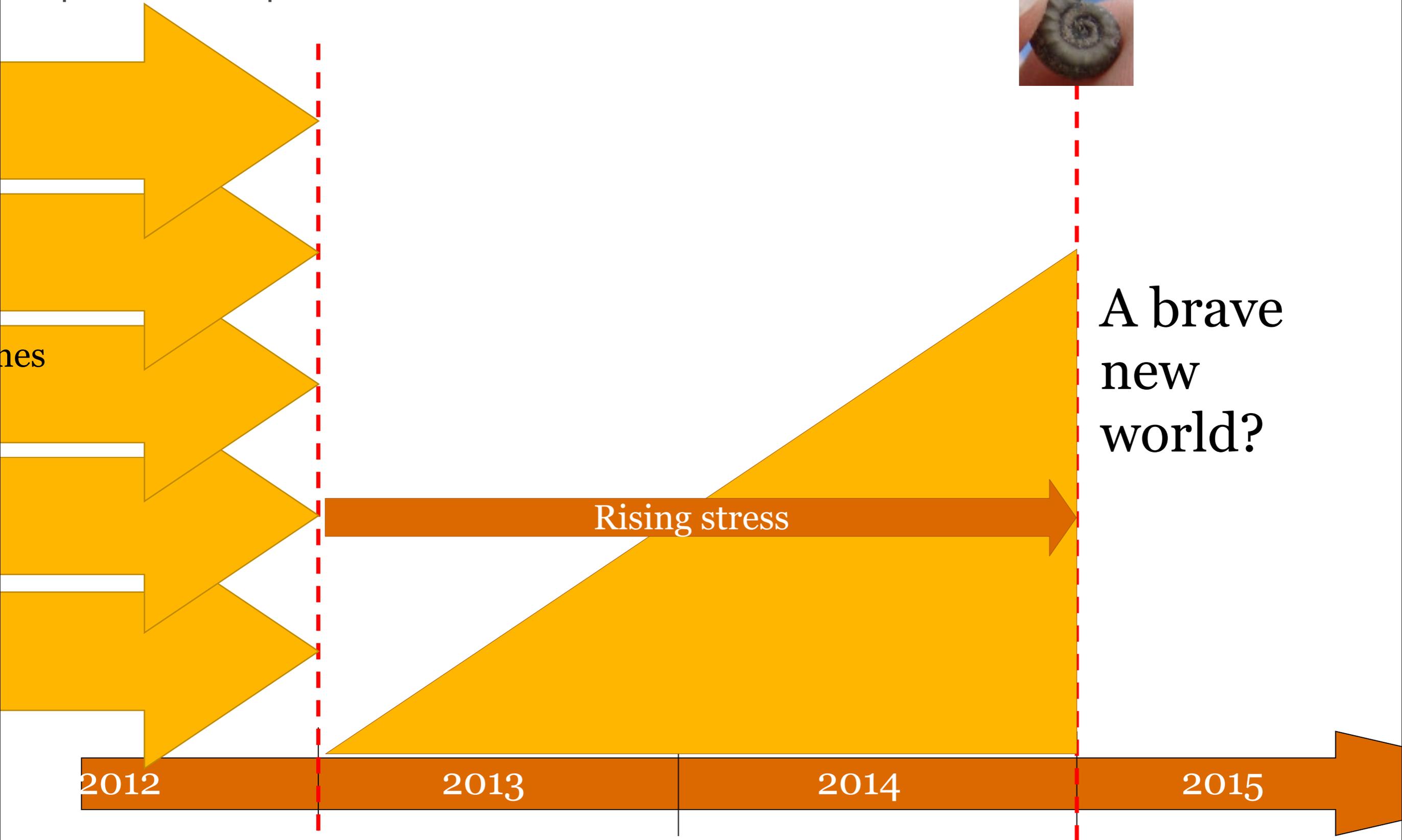
Debt maturity / complexity rises to a peak
Run up to introduction of Basel III

A brave
new
world?

2011

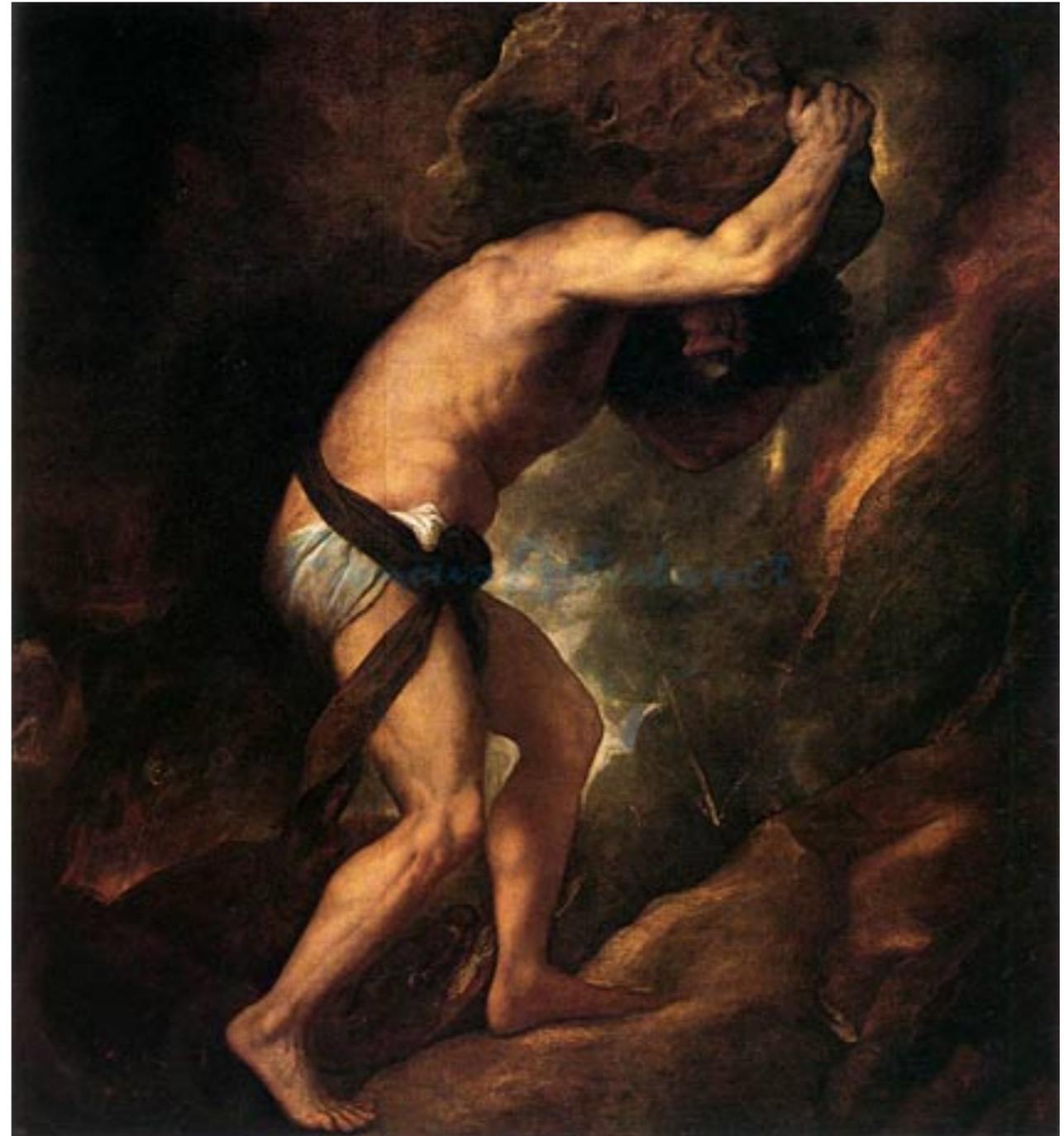
2012

The view in Autumn 2012 when the update was published.



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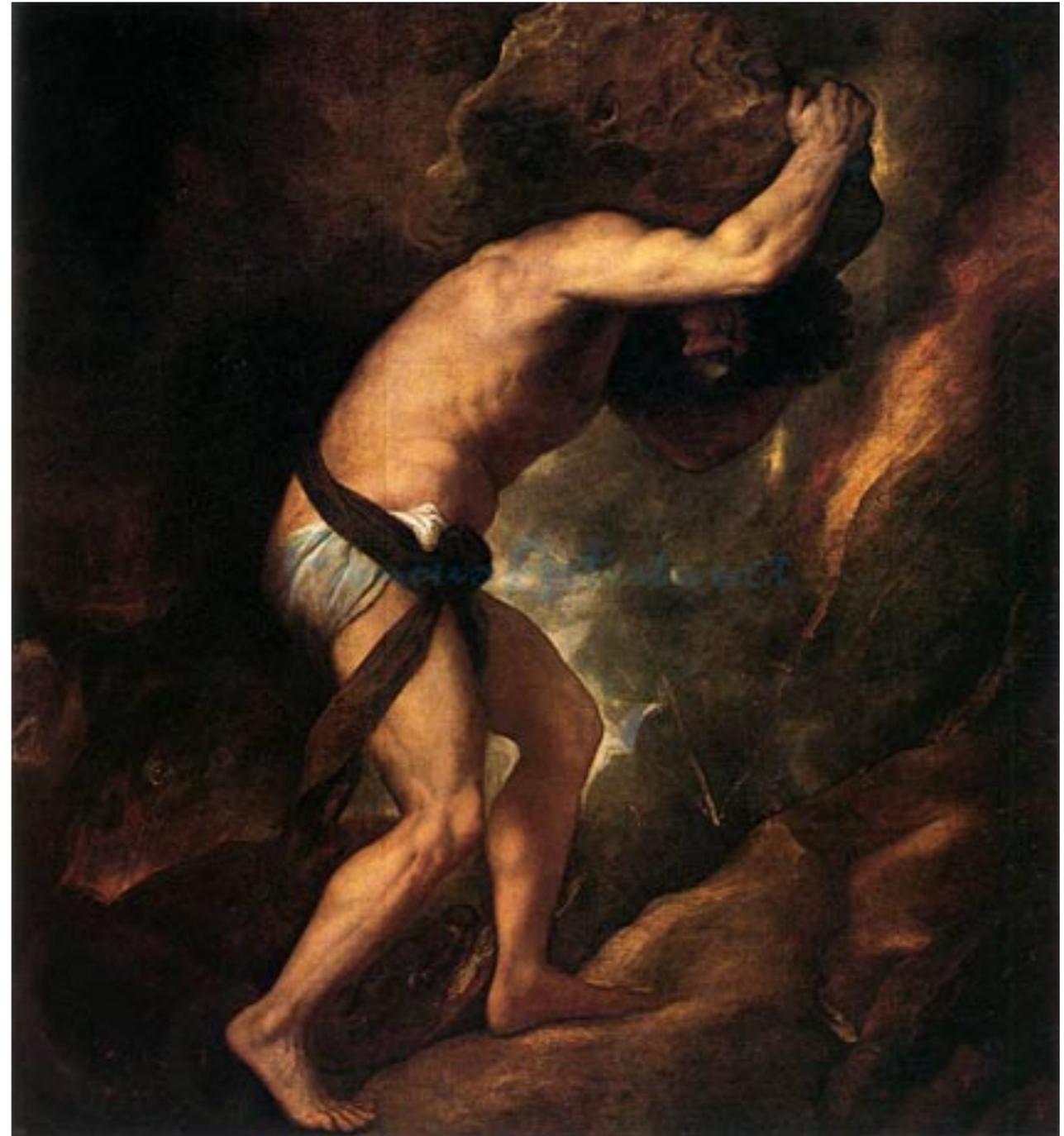


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The burden of regulation

- AIFMD



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Background

- AIFMD is the European Union Alternative Investment Fund Managers Directive.
- It became law across the EU on 22 July 2013.
- There will be a one year transition period during which time managers will need to become compliant. This will vary from manager to manager and country to country.



What is an AIFM?

An AIF is a collective investment undertaking other than a UCITS fund that raises capital from more than one investor and invests according to a defined investment policy on behalf of those investors.

Each AIF must have a single AIFM that is responsible for the portfolio and risk management of the AIF.



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Undertaking for Collective Investment
in Transferable Securities (EU
Directive 2009/EC/65)

An Alternative Investment Fund Manager as
defined in article 4 (1) (b) of the Directive

An Alternative Investment Fund as defined in article 4 (1)
(a) of the Directive

John Forbes

CONSULTING LLP



What is an AIFM?

The AIFM needs to meet requirements in respect of:

- Regulatory capital;
- Disclosure and transparency;
- Policies and procedures;
- Remuneration;
- Appointment of a depository.



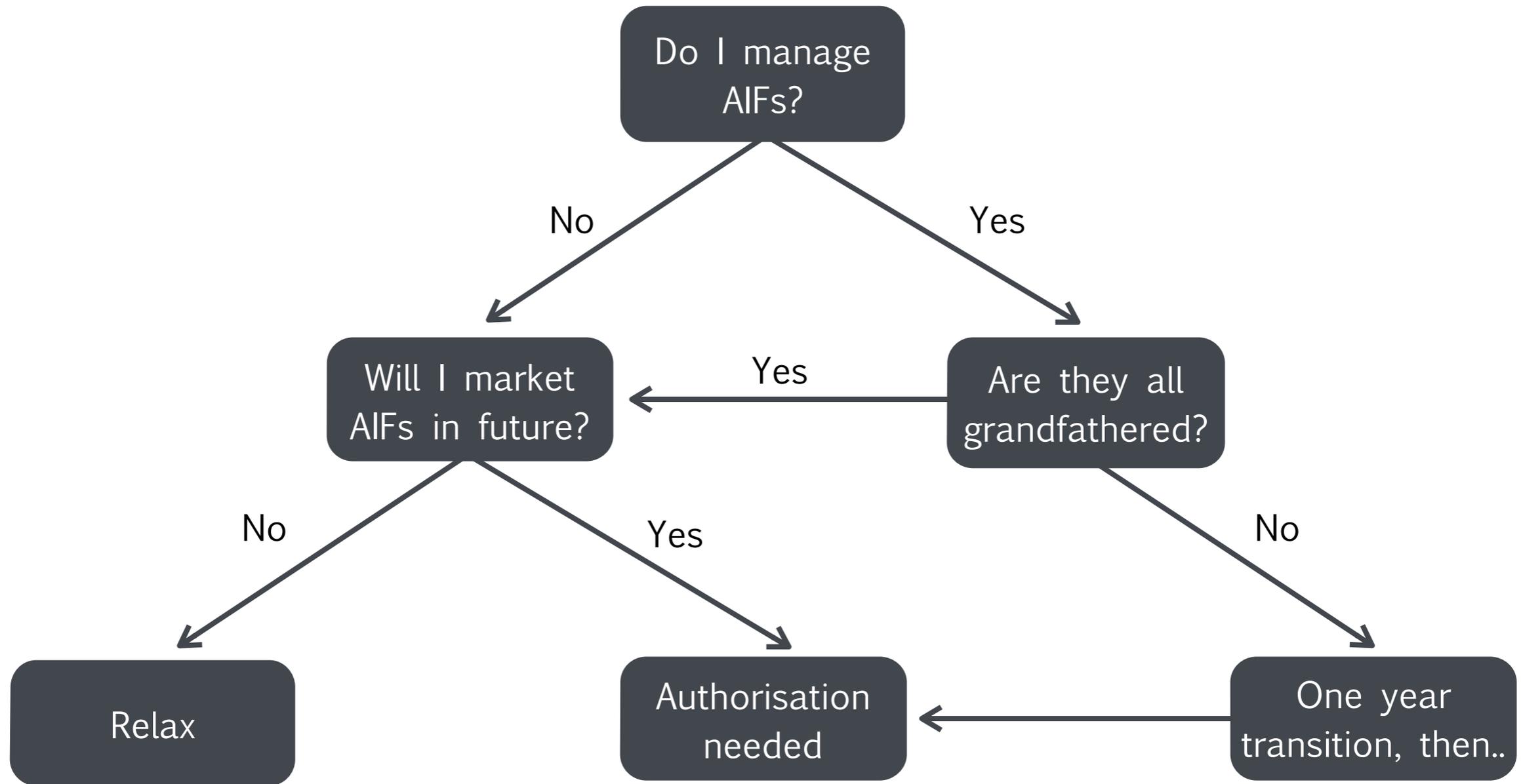
Impact of AIFMD on fund managers

	Marketing regime in the EU	AIFMD requirements to be applied
EU AIFM with EU AIF	AIF passport	Full AIFMD regime
EU AIFM with non-EU AIF	Private placement until 2018	Full AIFMD regime with reduced depository requirements
Non-EU AIFM with EU or non-EU AIF	Private placement until 2018	Transparency and disclosure requirements.

NOTE: EU and non-EU AIFM may be able to opt to use the AIF passport after 2015 in which case the full AIFMD requirements will apply.



Impact of AIFMD on fund managers



Role of the depository

The depository is responsible for:

- monitoring the AIF's cash flows;
- in respect of any financial instruments which belong to the AIF, holding such instruments in custody
- in respect of all other assets of the AIF, verifying whether the AIF (or AIFM acting on behalf of the AIF) holds an ownership interest in those assets, based on internal and external evidence of ownership;

and.....



Role of the depository

- The depository is responsible for ensuring that:
 - i). the sale, issue, repurchase, redemption and cancellation of units or shares of the AIF are carried out, and that the AIF's income is applied, in accordance with the applicable national law and the AIF rules;
 - ii). the value of the shares or units of the AIF are calculated in accordance with the applicable national law, the AIF rules and the valuation principles prescribed by the Directive;
 - iii). in transactions involving the AIF's assets, any consideration is remitted to the AIF within the usual time limits;
- And maintaining accurate records in relation to the above functions.



Latest developments

- FCA update August 2013 - the real timetable;
- ESMA opinion 1st August 2013. Practical arrangements for the late transposition of the AIFMD
- FCA guidance on remuneration, 6th September 2013.



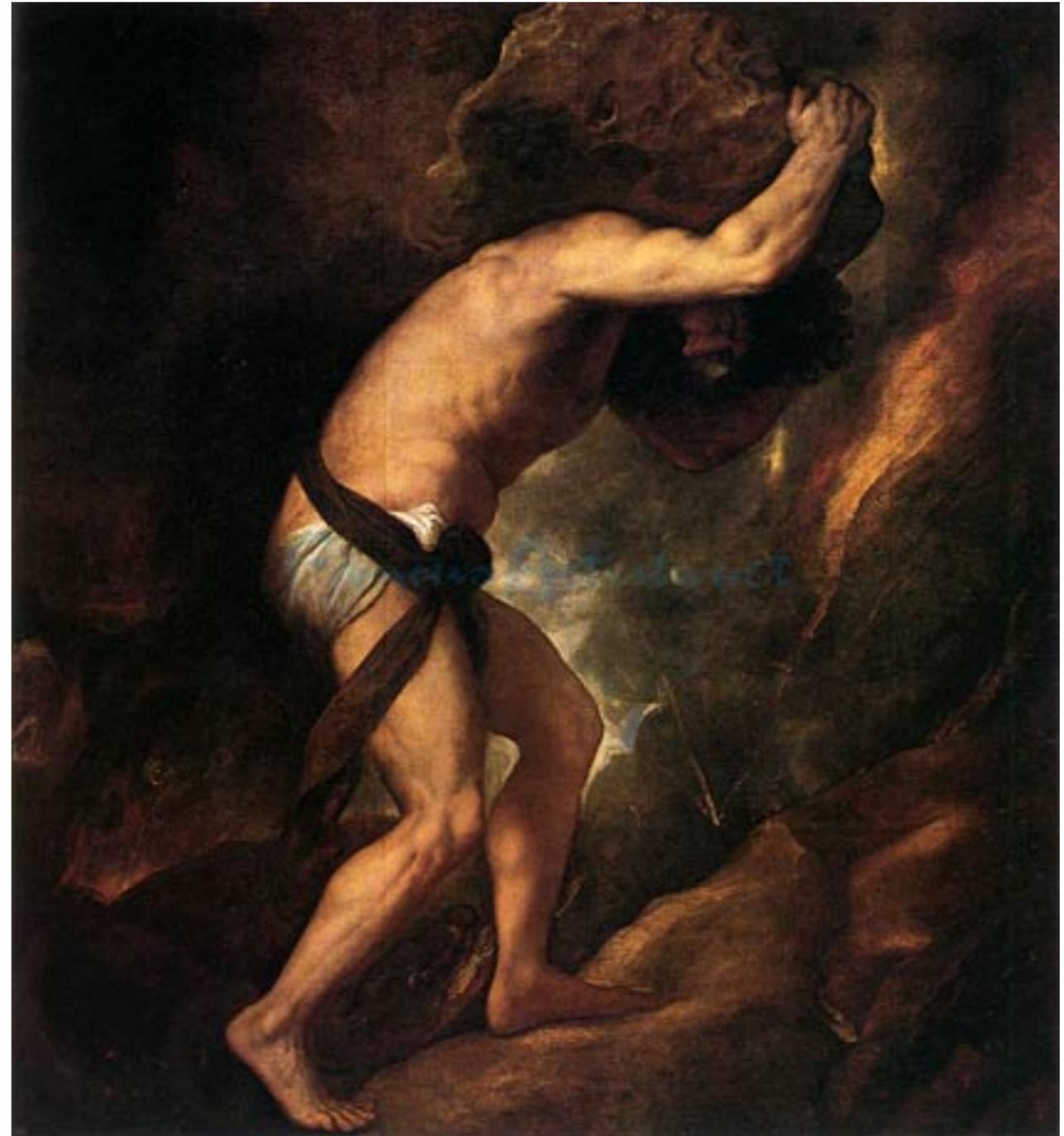
Interaction of AIFMD with other regulation

- EMIR
- CRD IV



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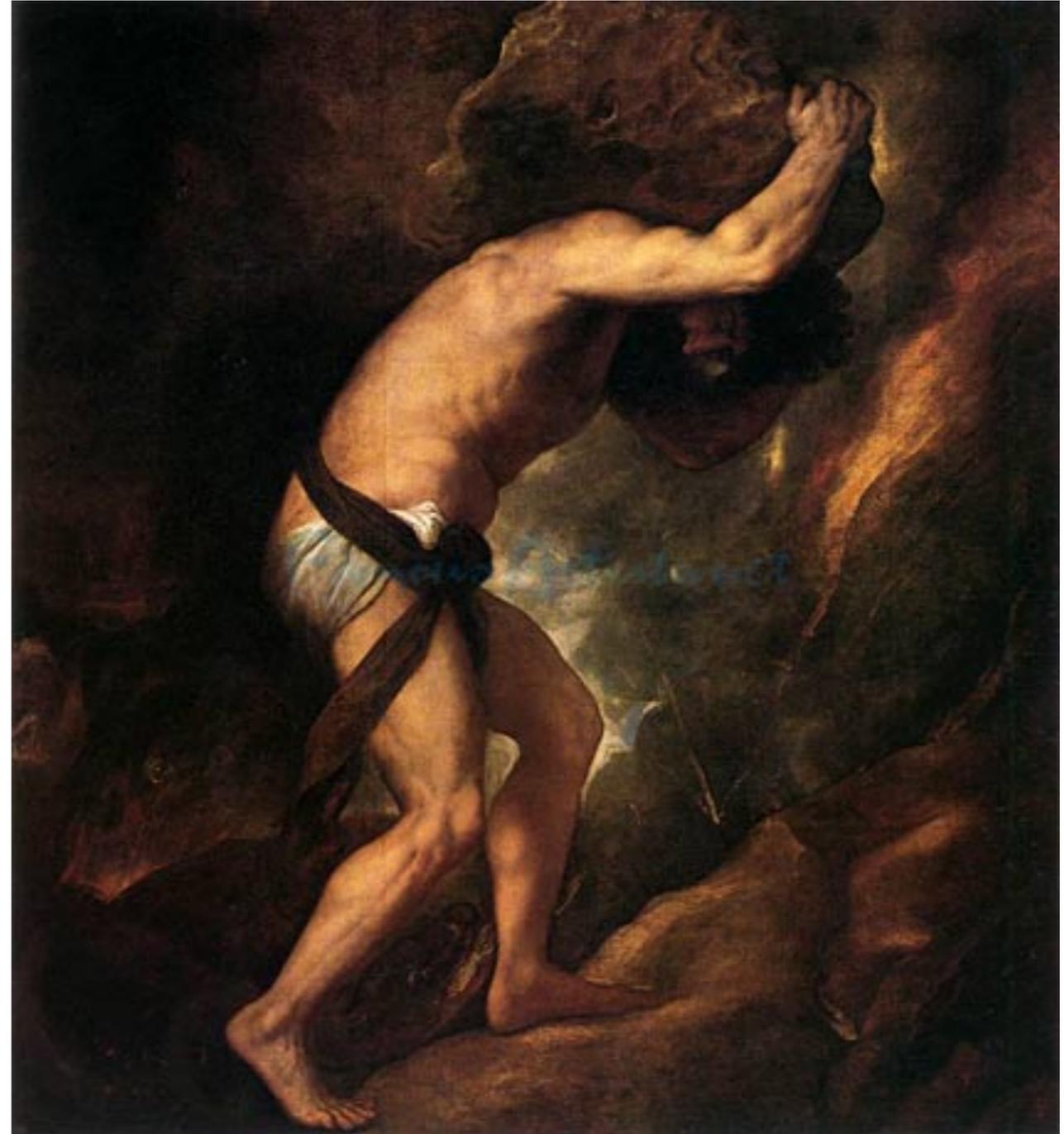


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The burden of regulation

- Dodd Frank



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What is Dodd Frank?

- Comprehensive regulation of the US Financial Services industry, became law in July 2010;
- Three years later, detailed regulation has only been drafted for 40% of it;
- Currently 14,000 pages of regulation for the 40% drafted so far, 1,200 pages of that relate to private funds;
- It requires private funds with real estate assets to register as “investment managers” and be regulated (although might be exempt and another exemption for this for most fund managers might be on the way..)



The exemption conundrum

- Real estate investment is exempt from the private funds rules under Investment Company Act Section 3(c)(5). It is unclear the extent to which the exemption applies to investment in shares in SPVs.
- There is a proposal under consideration to exempt mid-tier fund managers from Dodd Frank.
- Without exemption, managers of real estate funds will fall within the form PF reporting requirements.



Form PF reporting

	Hedge fund	Private equity fund	Liquidity fund	Other private fund
Definition of "large"	\$1.5 billion	\$2 billion	\$1 billion	N/A
Over "large"	Complex quarterly	Fairly complex quarterly	Fairly complex quarterly	N/A
Over \$150 million	Simple annual	Simple annual	Simple annual	Simple annual
Under \$150 million	Not required	Not required	Not required	Not required



Form PF reporting

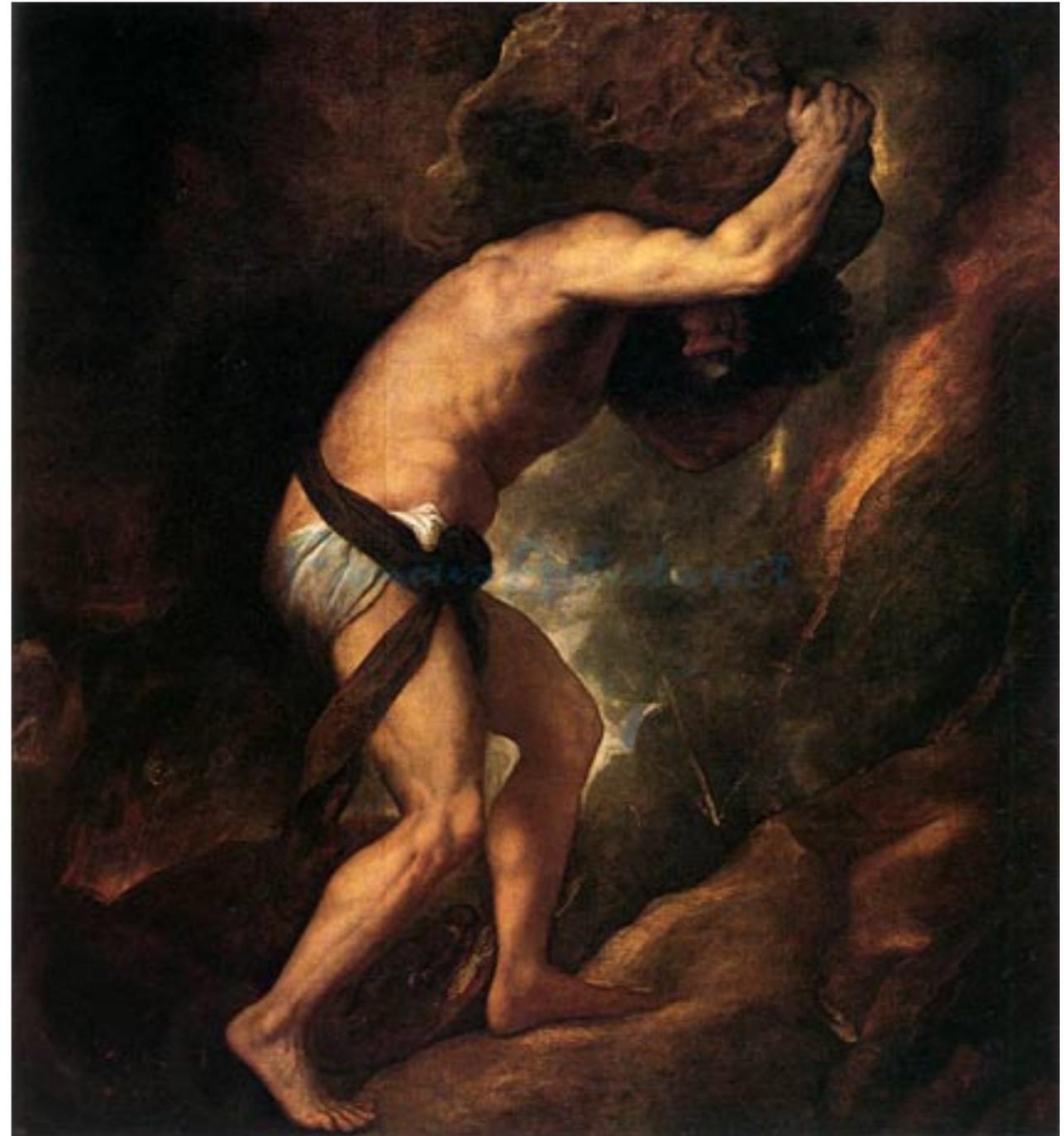
Real estate

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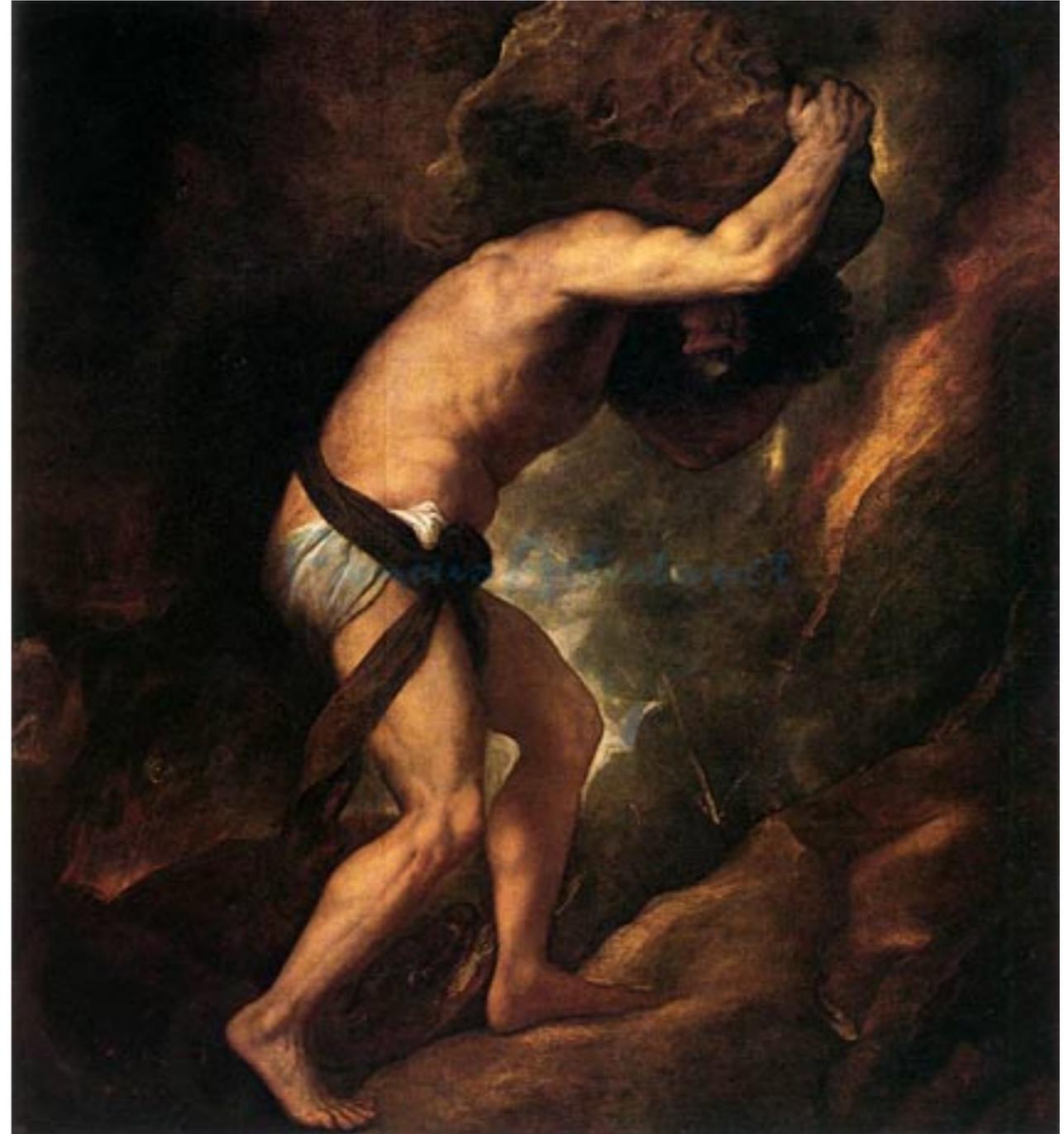


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The burden of regulation

- FATCA



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Foreign Account Tax Compliance Act

Comprehensive tax reporting regime designed to combat tax evasion through the use of offshore bank accounts:

- Part of the 2010 Hiring Incentives to Restore Employment (HIRE) Act
- Proposed regulations published in 2012;
- Final regulations published January 2013;
- Fund managers need to be compliant by 1st January 2014.



Foreign Account Tax Compliance Act

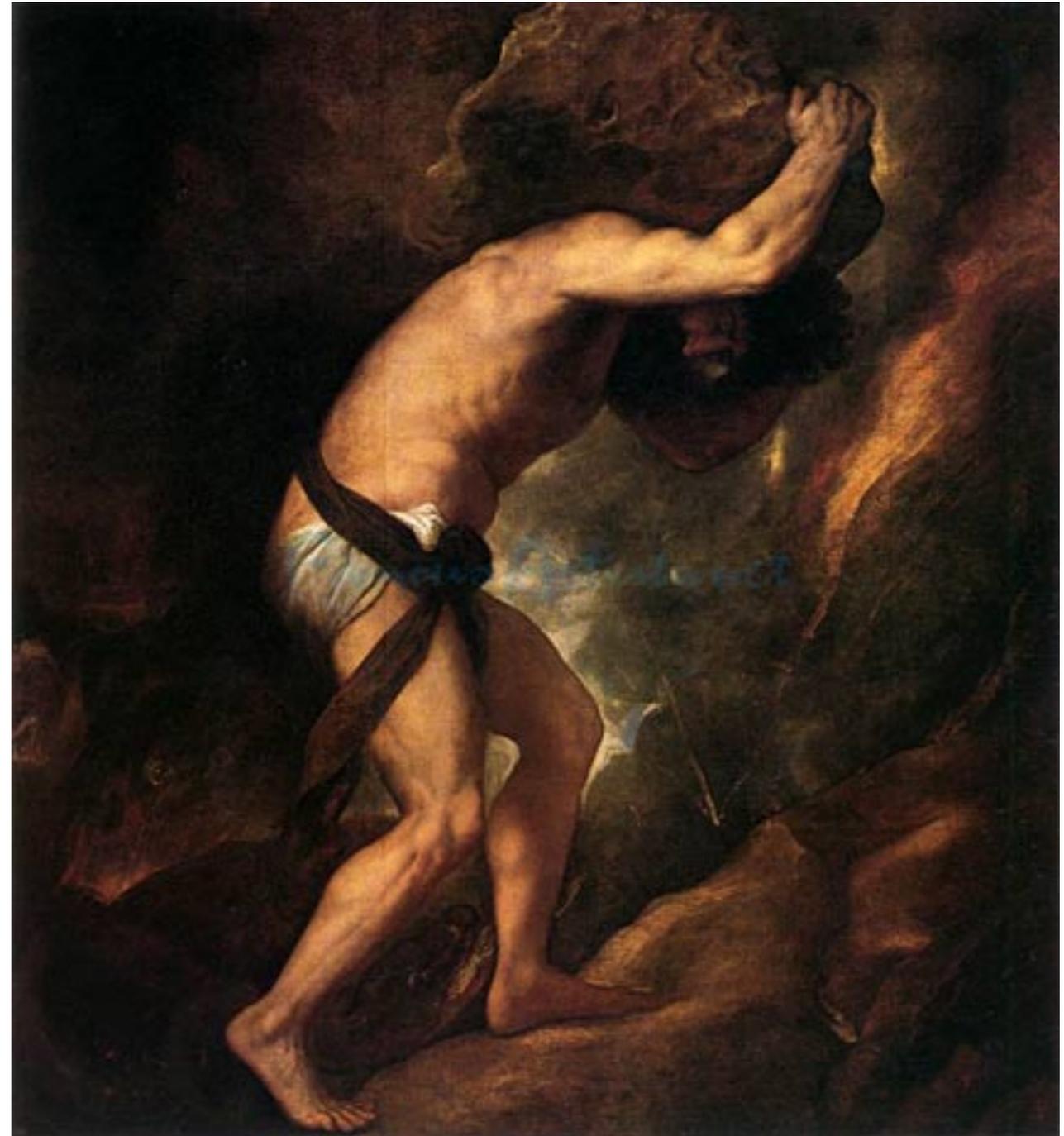
Fund managers need to:

- Determine their classification under FATCA and register with the IRS where appropriate
- Review their investor base
- Gather documentation
- Conduct due diligence on investors
- Implement new tax information and reporting procedures
- Withhold on payments where appropriate
- Verify compliance with the requirements of FATCA



The burden of regulation

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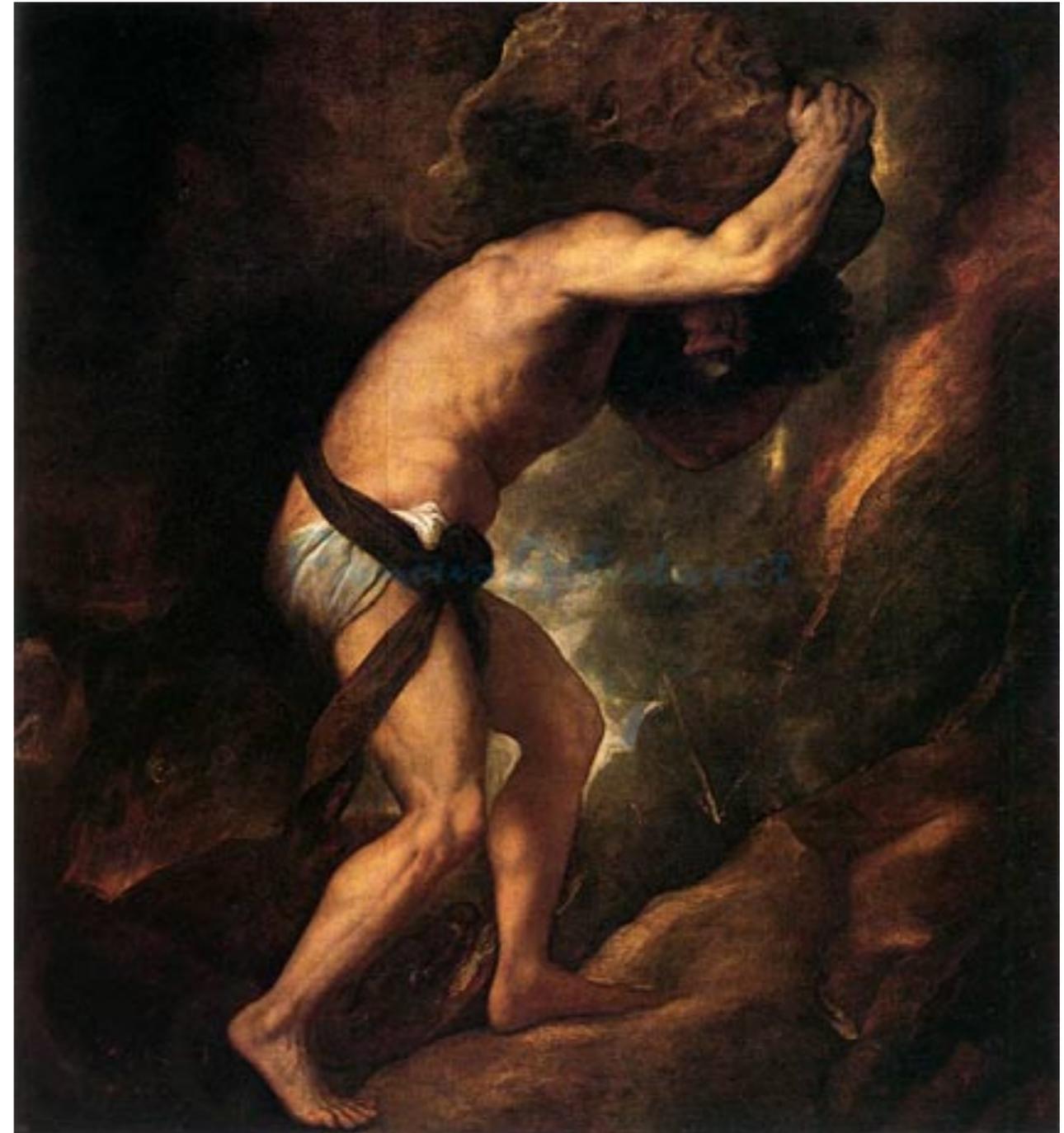


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The burden of regulation

- Solvency II and IORP



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Solvency II and IORP

Solvency II

A fundamental reform of the capital adequacy regime for the European insurance industry.

It aims to establish a revised set of EU-wide capital requirements and risk management standards to reduce systemic risk in the insurance industry

IORP

Institutions for Occupational Retirement Provisions Directive - the equivalent provisions to Solvency II for pension funds.



The three pillars

Pillar I: Quantitative aspects;

Pillar II: Governance and risk management;

Pillar III: Reporting and disclosure.



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The three pillars

Pillar I: Quantitative aspects;

Pillar II: Governance and risk management;

Pillar III: Reporting and disclosure.



Capital charges (Solvency Capital Requirement)



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The three pillars

Pillar I: Quantitative aspects;

Pillar II: Governance and risk management;

Pillar III: Reporting and disclosure.

Capital charges (Solvency Capital Requirement)



Reporting requirements



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The three pillars

Pillar I: Quantitative aspects;

Pillar II: Governance and risk management;

Pillar III: Reporting and disclosure.

Capital charges (Solvency Capital Requirement)

Reporting requirements



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Capital requirements

Once Solvency II is in force, insurers will be required to model the capital that they will need to hold in respect of potential future falls in value of their investments.

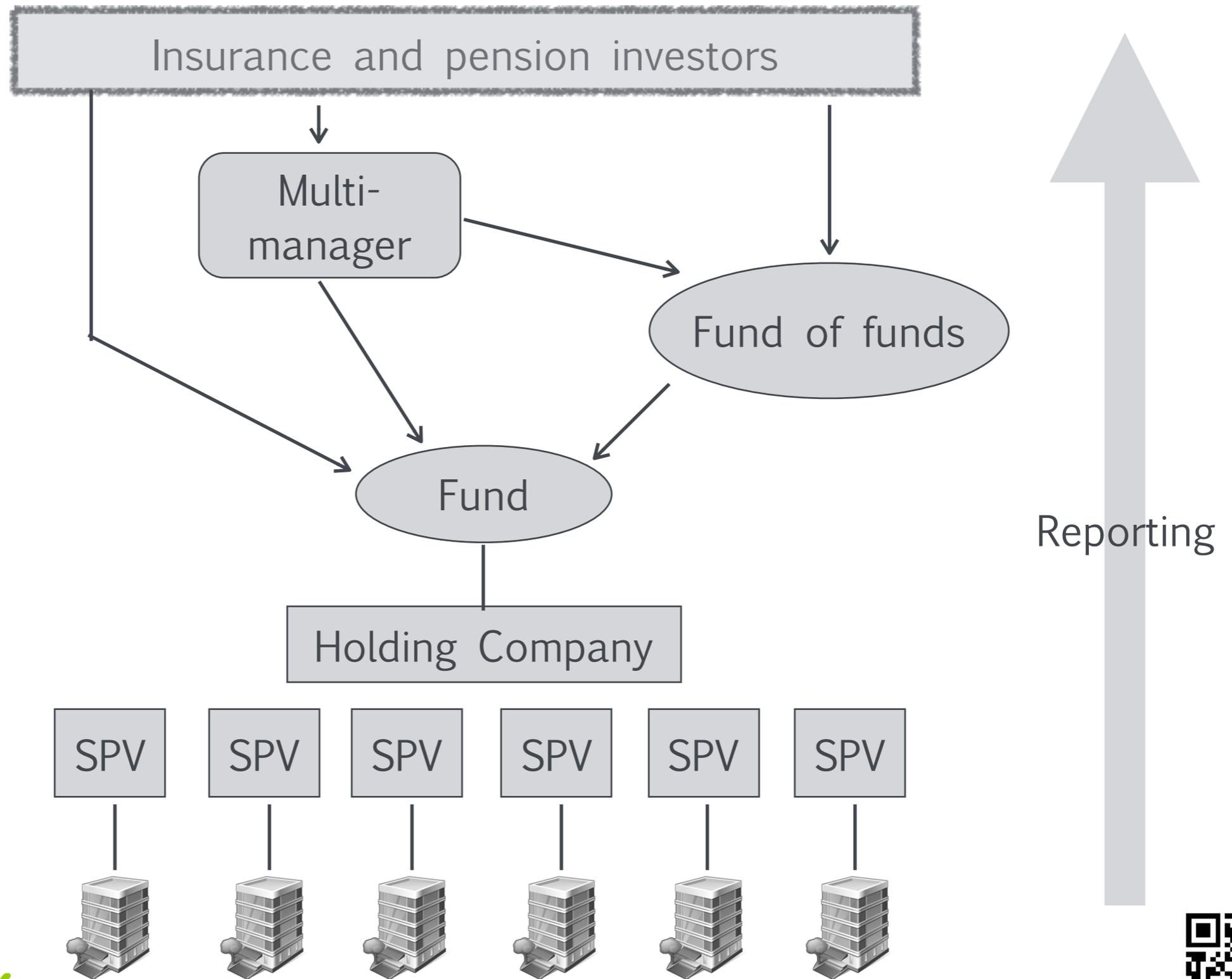
Insurers can either use a “standard formula” for which the risk factors are set down by the EU regulator, the European Insurance and Occupational Pensions Authority (EIOPA) or seek approval from their national regulator to use their own internally generated risk model.

25% "shock" for real estate under the standard model.

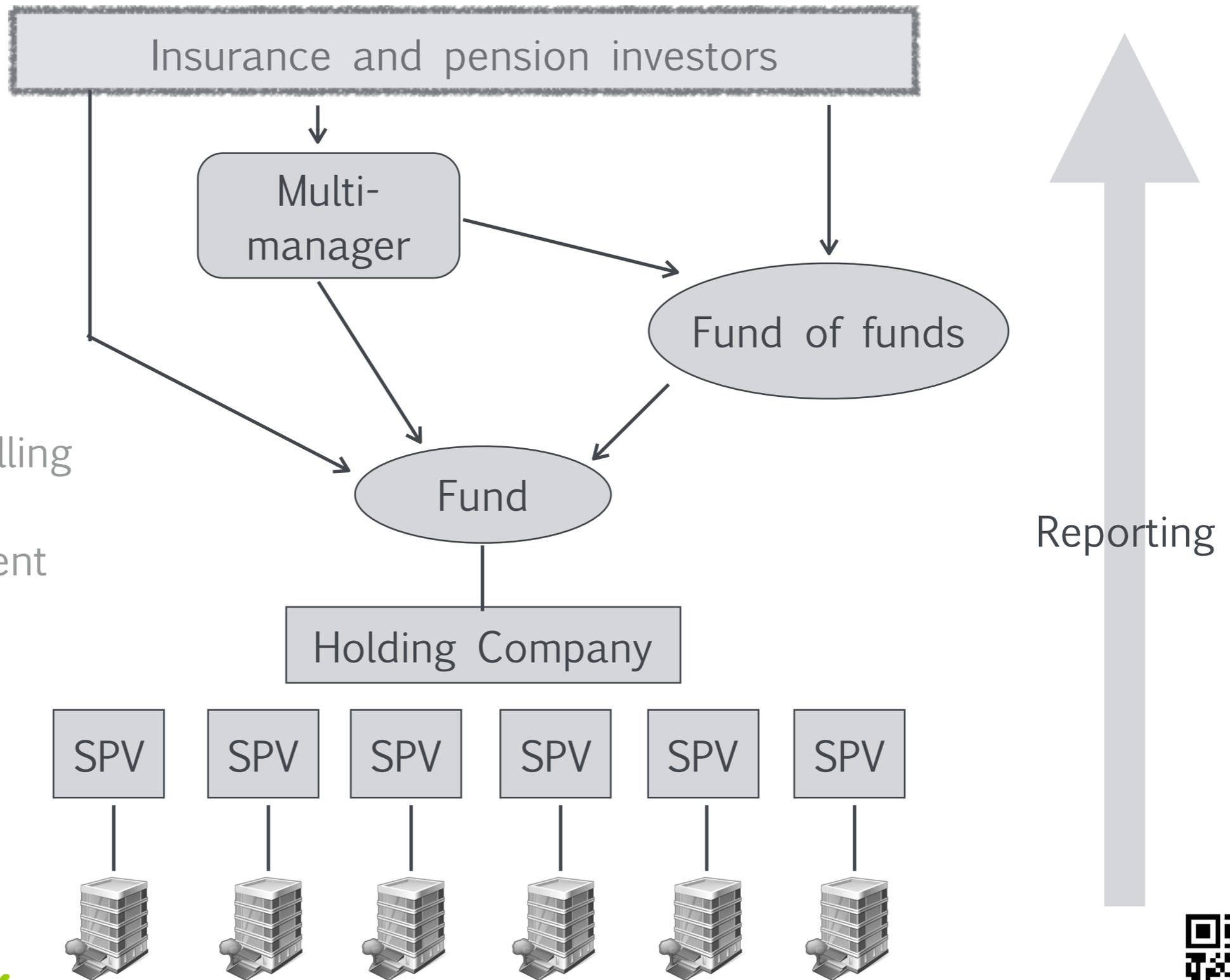
The equivalent provisions under IORP have been delayed.



Reporting requirements



Reporting requirements

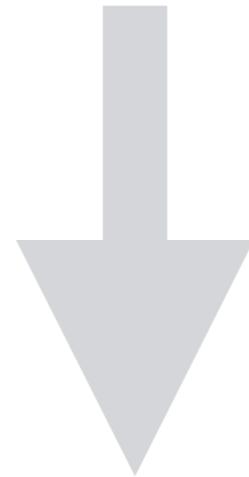


- Data for modelling
- Controls
- Risk management
- Governance



When will it happen?

- Indicative date for Solvency II vote - 11 March 2014
- No date for IORP and pillar I deferred until further notice.

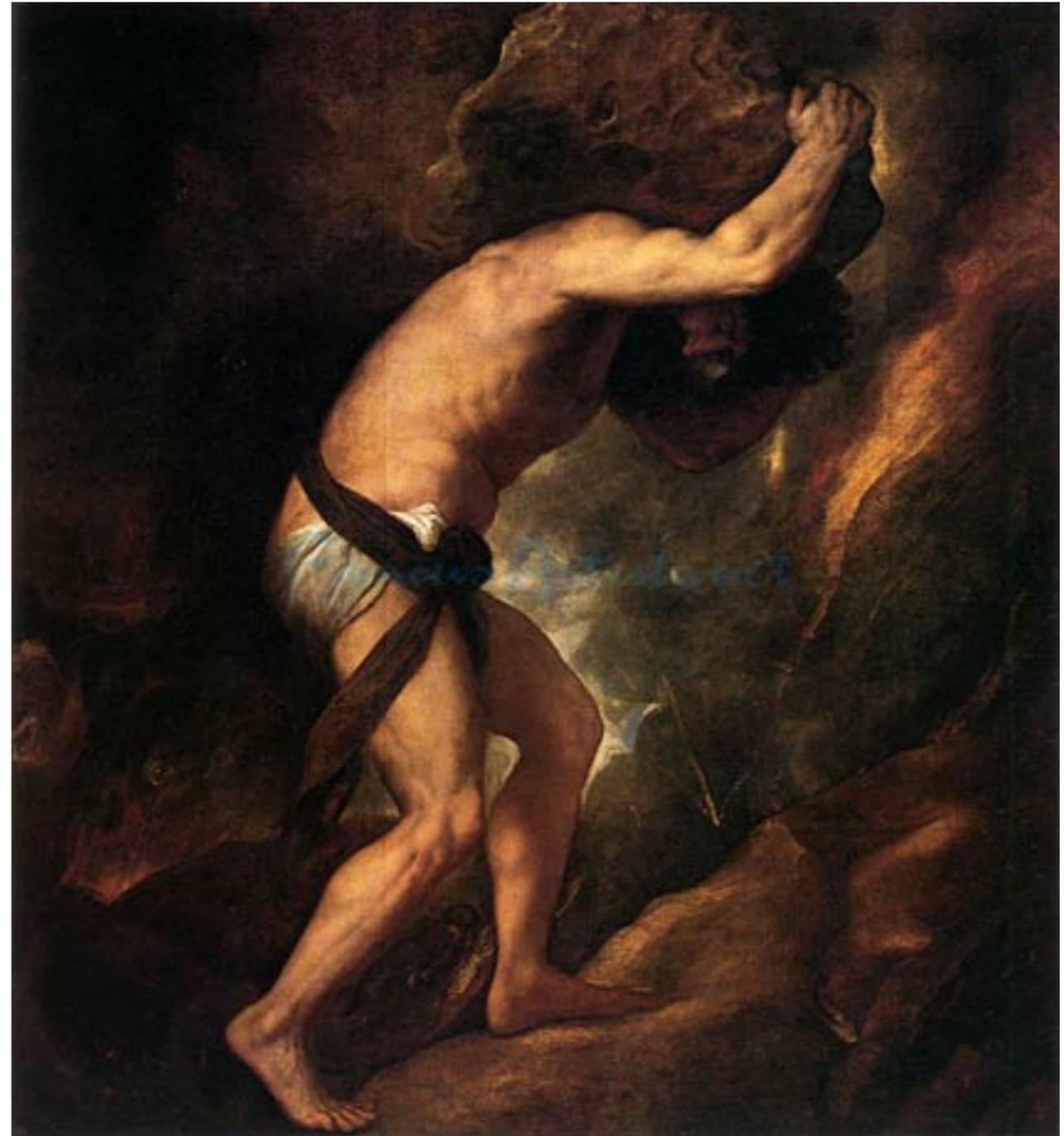


1st January 2017



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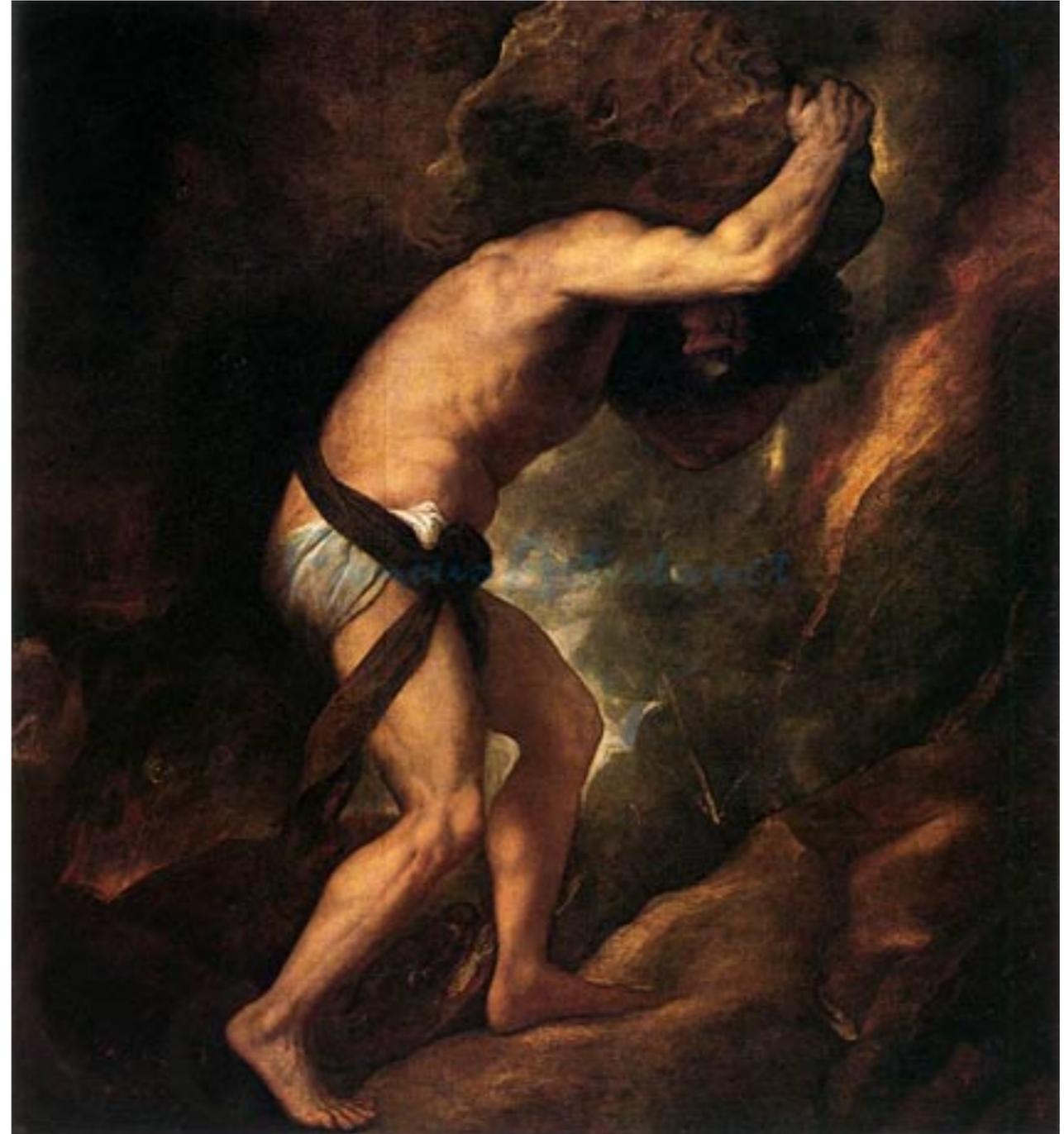


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The burden of regulation

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- Some common themes
- What do I do as an investor?



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Some common themes

- Regulatory uncertainty - formal regulation lagging introduction;
- Written policies, procedures and controls;
- Reporting to investors and regulators;
- Due diligence
- Enhanced governance



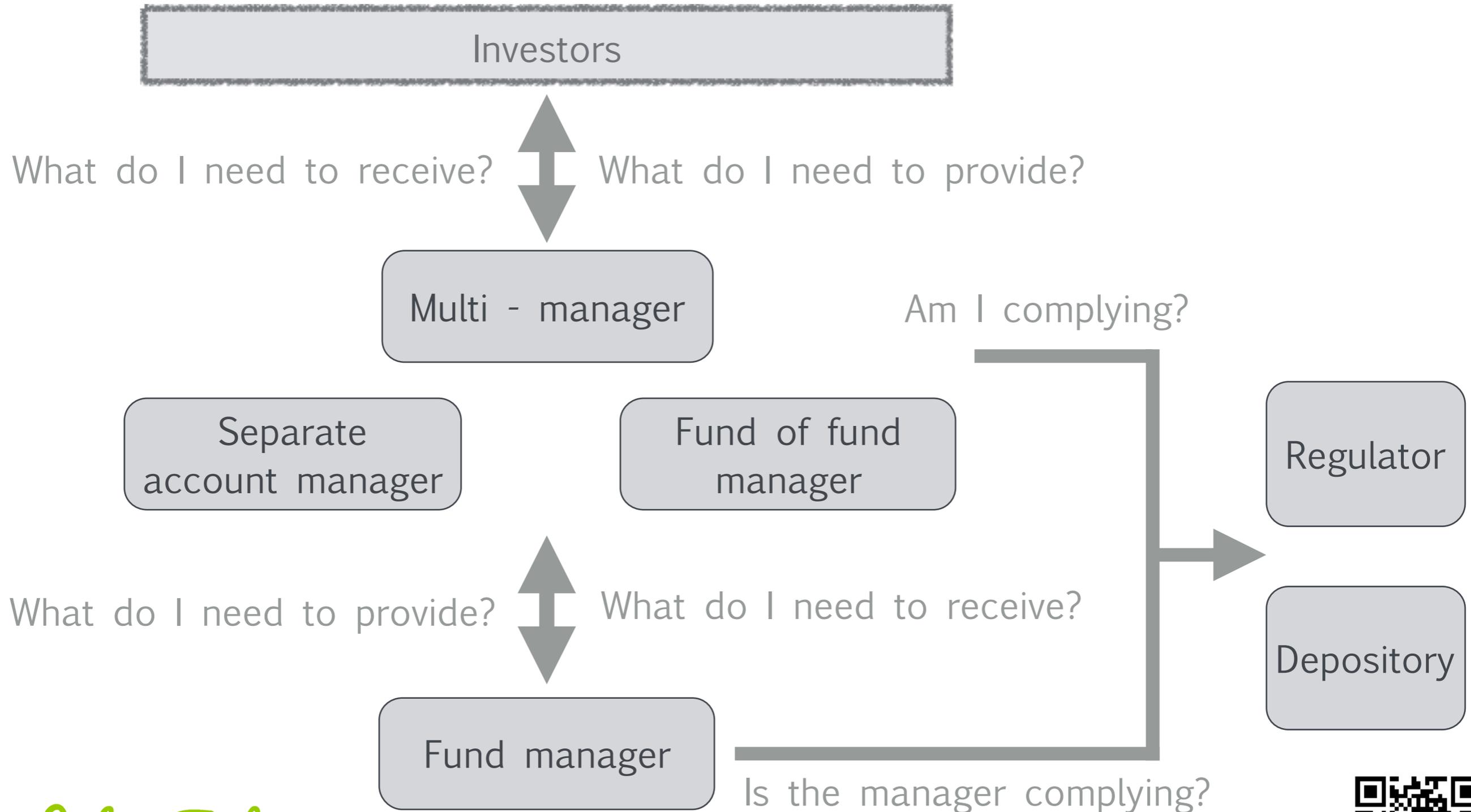
Impact of regulation on governance

Why is regulation going to create a need for more transparency, stronger governance and greater independent supervision?

- Explicit requirement of regulation;
- A means of satisfying general conduct of business requirements of regulation
- Resolving non-alignment of interest issues arising from requirements of regulation
- Reassuring stakeholders



The information flow



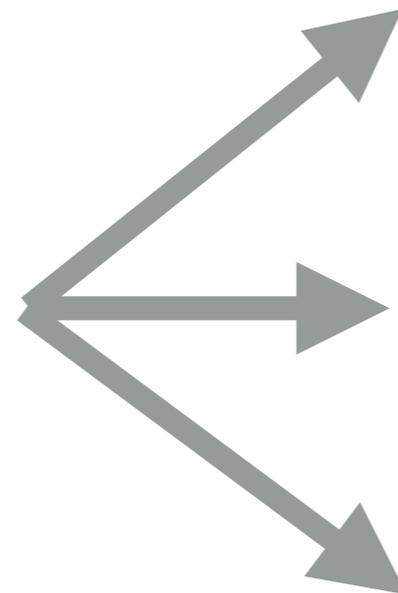
The crucial issues for the investor

Is the manager able to deal with regulatory requirements?



Upfront due diligence

Is the manager complying on an ongoing basis?



Ongoing monitoring by the investor

Audit / ISAE3402

Ongoing monitoring by the depository / regulator

Does the manager still have a viable business after the costs?

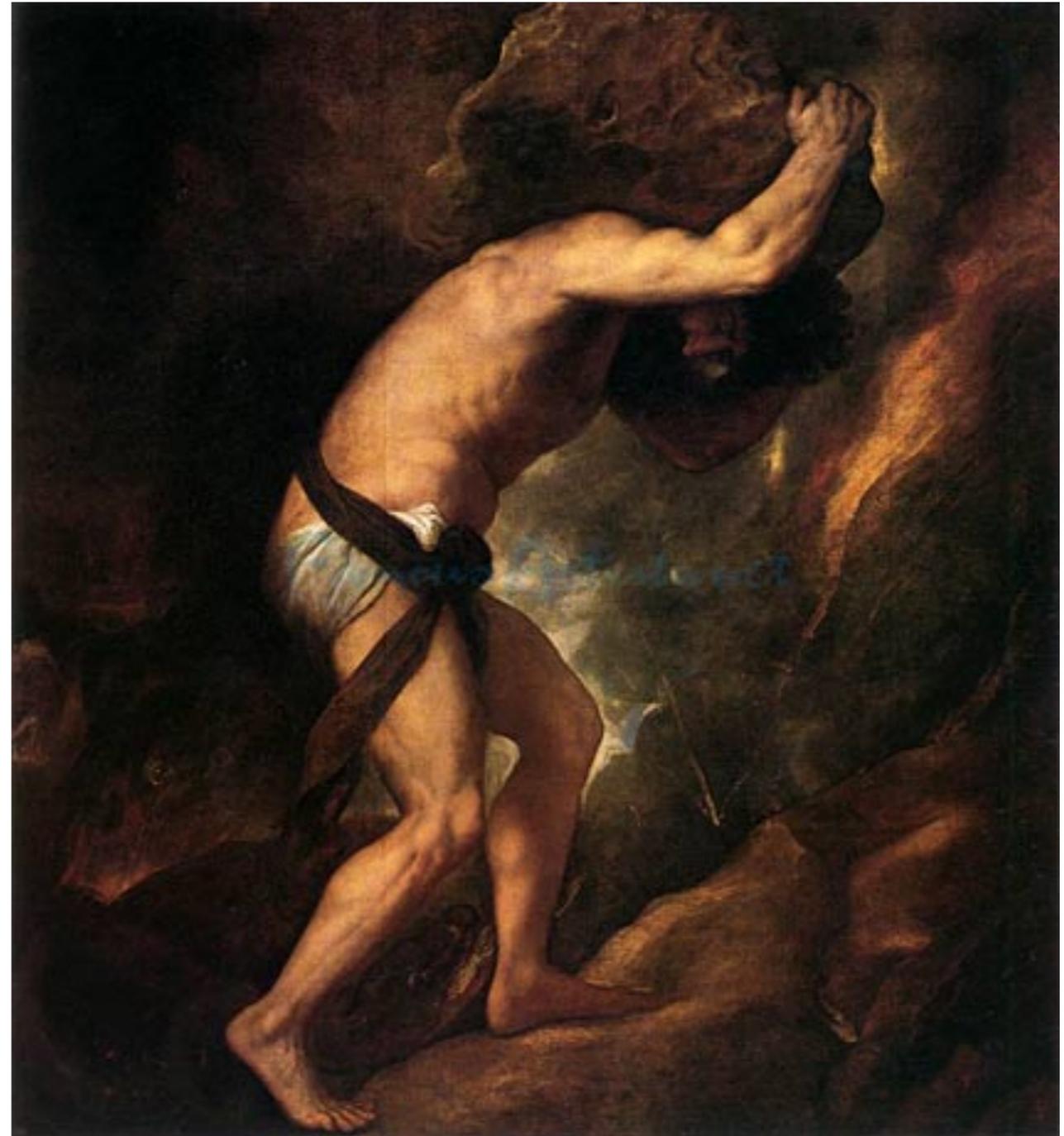


Impact on fees



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