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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

January 31, 2013

Submitted at www.esma.europa.eu

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103 Rue de Grenelle
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Re: Consultation Paper – Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM

The National Association of Real Estate Investment Trusts¹ (NAREIT) welcomes the opportunity to provide comments on the European Securities and Markets Authority's (ESMA) December 19, 2012 Consultation Paper (ESMA/2012/845; the Consultation Paper) on the Alternative Investment Fund Managers Directive² (AIFMD or Directive) and types of AIFM.³

We are very supportive of the approach that ESMA has taken in seeking to provide guidance on the types of Alternative Investment Funds (AIF) covered under the Directive, and are grateful for continued efforts that ESMA and other participants in the process have made to clarify the scope of the application of the Directive. Throughout this process, NAREIT, whose members are primarily U.S. based publicly traded real estate investment trusts (REITs) that own, develop, operate and manage real estate assets, has focused its efforts with EU policymakers on the question of the scope of the Directive.

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.

² Directive 2011/61/EC 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 and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

³ This comment follows on NAREIT's March 21, 2012 submission commenting on ESMA's February 23, 2012 discussion paper setting forth key concepts of the Alternative Investment Fund Managers Directive and types of AIFM (ESMA/2012/117) (the March 21, 2012 Submission).



Our principal concern with the application of the Directive has been that the real estate industry, i.e., the business sector which acquires, owns and operates, manages, constructs, refurbishes, develops and provides services related to land and buildings as a business could be confused with funds that invest in assets backed by real estate. We believe that the scope of the AIFMD should be clearly defined in such a way as to include fund managers—including fund managers that invest in real estate-- and exclude those which are not fund managers, but rather own and operate land and buildings as a business, a category that includes most listed US-based equity REITs and many other publicly listed real estate concerns.

NAREIT's primary objective is to avoid a circumstance whereby real estate market participants, including our US REIT members, would face an uncertain regulatory landscape in Europe, unsure of whether they were obliged to comply with not only the AIFMD, but other pieces of EU financial services legislation that apply to AIFs (e.g., derivative clearing and margining requirements under the European Market Infrastructure Regulation (EMIR). We believe that the key concepts advanced in the Consultation Paper contribute much beneficial clarification of the likely scope and application of the Directive and will prove to be useful in dispelling regulatory uncertainty.

NAREIT is particularly supportive of ESMA's helpful and functional elaboration of the concept of the "Defined Investment Policy," which we believe will prove to be the most useful criterion to distinguish AIFs from other entities. The Defined Investment Policy is one of the most apparent, and clear, operational differentiations between a fund and an ordinary commercial undertaking. We believe that the characteristics of a Defined Investment Policy set forth in the Consultation Paper are very likely to prove helpful to many market participants.

In the same spirit, NAREIT welcomes ESMA's introduction of the concept of an 'ordinary company with general commercial purpose' and the recognition that these types of businesses are wholly distinct from "collective investment undertakings," and are appropriately not within the scope of the AIFMD.

Below we set forth a more detailed response to certain of the specific questions set forth in the Consultation Paper.

Detailed Comments

Q1: Do you agree with the approach suggested above on the topics which should be included in the guidelines on key concepts of the AIFMD? If not, please state the reasons for your answer and also specify which topics should be re-moved/included from the content of the guidelines.

We support the approach and the topics to be included in the guidelines on key concepts of the AIFMD and agree that these are likely to prove useful in differentiating between investment funds and ordinary business undertakings.



NAREIT also supports the inclusion of the explicit statement that it is “only when all the elements included in the definition of AIFs under Article 4(1)(a) of the AIFMD are present that an entity should be considered an AIF.” This, however, poses the question of whether a market participant may conclude that the absence of any of these four elements conclusively establishes that an entity is not to be considered an AIF. If so, it would be helpful if ESMA were to set forth a similar explicit statement in this regard.

We also suggest that it could be beneficial to include the additional concept of “valuation approach” to the key concepts. AIFs, 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). This is true even of investment funds that happen to be listed/traded on major stock exchanges. 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.

Q3: What are your views on the notion of ‘raising capital’? Do you agree with the proposal set out above? If not, please provide explanations and possibly an alternative solution.

We believe that this concept, subject to further refinement set out below, together with the other factors that ESMA has identified, serve as a very useful group of criteria to distinguish an AIF from another type of commercial entity. We would urge ESMA to consider identifying the link between capital raising and the Defined Investment Policy (DIP) as a relevant factor, 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. Moreover, we believe that two additional factors might be useful in distinguishing AIFs from ordinary businesses in this context.

Raising Capital with a Sponsor: Typically, AIF’s will raise capital through a “sponsor” that plans (itself or through a group member) to make a profit out of the management of the capital raised from third party/external sources.

Raising Debt from Public Markets: 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.

Q5: Do you agree with the proposed guidance for identifying a ‘collective investment undertaking’ for the purposes of the definition of AIF? If not, please explain why.



We are broadly supportive of the guidance set forth for identifying a “collective investment undertaking.” We particularly welcome the statement that a collective investment undertaking is not an “an ordinary company with general commercial purpose,” which we believe, with further refinement, will be extremely useful for distinguishing AIFs from other entities. We similarly support the linking of a collective investment undertaking to a “pooled return” defined in the Directive as one “generated by the pooled risk arising from acquiring, holding or selling investment assets,” and therefore distinct from “activity of an entity acting for its own account and whose purpose is to manage the underlying assets as part of a commercial or entrepreneurial activity, irrespective of whether different returns to investors, such as under a tailored dividend policy, are generated.”

Q7: Do you agree with the analysis on the absence of any day-to-day investor discretion or control of the underlying assets in an AIF? If not, please explain why.

NAREIT is generally in agreement with this concept, but shares a concern expressed in some of the comments ESMA excerpted in the Consultation Paper, which note that “day-to-day investor discretion” could prove to be confusing, as neither investors in funds nor shareholders in business undertakings are likely to have day-to-day discretion in the minds of many.

We suggest that 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 on an ongoing basis. A normal business undertaking will typically seek shareholder approval for matters when 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). In contrast, in the case of a fund, investor consent issues usually are a matter for negotiation between the AIFM and the investor at the time that the AIF is launched, or the investment is made and an investment agreement or investment mandate (covering issues such as investment in a new geography, borrowings over a certain level, extension of the investment period) is agreed by the two parties. [An AIF investment agreement typically will confer on the AIFM full management discretion pursuant to a DIP.](#)

Q8: Do you agree that an ordinary company with general commercial purpose should not be considered a collective investment undertaking? If not, please explain why.

NAREIT agrees with this concept and is pleased that ESMA has emphasized this point in the Consultation.

Q9: Which are in your view the key characteristics defining an ordinary company with general commercial purpose?



Below is a list of characteristics that NAREIT believes are common to ordinary commercial companies, and provide a clear distinction with investment funds, which will generally exhibit few, if any, of the below characteristics. Although not every criterion will be present in each case, when considered in aggregate, we believe this list sets forth a clear view on whether the entity in question is a fund or a normal operating business:

1. having a perpetual corporate existence with only one set of shareholders - permanent share capital that is transferable, but not contingent on the investment horizon or status of individual shareholders;
2. having a perpetual and continuously evolving business operating model, as opposed to seeking new investors for each fund that has a differing finite life;
3. having shares regularly traded on a nationally recognized stock exchange;⁴
4. operating under a set of regulatory rules other than those applicable to collective investment entities - such as the 1940 Act in the United States or the UCITS Directives in Europe;
5. issuing debt in the public markets that is subject to ratings agencies review;⁵
6. having “internalized management” so that the business plan of each company is executed by full-time employees;
7. executing business plans to operate their business for the long-term - without predetermined objectives to sell or spin-off a separate business;
8. the metric that investors typically use to assess performance of the business is by reference to growth in earnings and dividends, rather than merely net asset values.

Q12: Do you agree with the proposed indicative criteria for determining whether a ‘defined investment policy’ exists for the purposes of the definition of AIF? If not, please explain why.

NAREIT strongly supports the use of “Defined Investment Policy,” (DIP) as the pivotal characteristic to distinguish between funds and normal operating businesses, and we believe that a strong definition of what constitutes a DIP will prove to be the most valuable tool for policymakers, regulators, and the market to distinguish AIFs from other entities. In this regard, we also strongly support the proposed indicative criteria set forth in the consultation, and commend ESMA for its efforts to provide a useful characterization of the DIP.

⁴ This is not to deny that private, unlisted property companies can also fall outside the scope of the AIFMD as well.

⁵ It is typically only large publicly listed companies that issue unsecured debt in the capital markets based on a corporate rating. For many smaller listed companies (and for most private companies) it is only possible to issue capital markets debt on a secured basis (with a rating referable to the underlying secured assets and income streams).



We are particularly pleased that ESMA has noted that a defined “investment policy is determined and fixed, at the latest by the time that investors’ commitments to the undertaking become binding on them.” We agree that this characteristic usefully distinguishes a DIP from a business strategy, which is a discretionary management objective and is never formally fixed. Similarly, we agree with ESMA that “the undertaking or the entity managing it [the DIP] has an obligation (however arising) to investors, which is legally enforceable by them, to follow the investment policy....”*e.g.*, that the AIFM has a legal obligation to follow the DIP.

As noted above, we believe that the link between the raising of capital and the DIP could be usefully added to this listing, *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.

Q14: Do you consider appropriate to add in Section IX, paragraph 16(b) of the draft guidelines (see Annex V) a reference to the national legislation among the places where (in addition to the rules or instruments of incorporation of the undertaking) the investment policy of an undertaking is referenced to?

To the contrary, NAREIT believes that the inclusion of references to national laws referencing investment policies would be confusing and would weaken the concept of a DIP. While it is true that various national laws impose obligations on AIFs, these are distinct from a DIP, which is a contractual obligation owing to investors from the sponsor of an AIF. NAREIT believes that market participants will be best served if the concept of the DIP is *not* confused with various policy considerations.

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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