

# AIFMD: Spotlight on risk management



## What is the AIFMD?

In the aftermath of the global financial crisis, the European Commission drafted one of the most ambitious and complex regulatory reform agendas ever introduced into the asset management industry in the form of the Alternative Investment Fund Managers Directive (AIFMD). The Directive will have profound, wide-reaching and long-term implications for in-scope alternative investment fund managers (AIFMs).

## A new era in risk management

As part of an effort to prevent the recurrence of recent financial crises associated with unregulated investment vehicles, the AIFMD introduces a set of rigorous new risk management requirements for AIFMs and the alternative investment funds (AIFs) they manage. In addition to helping improve the stability of the alternative investment sector, these changes are also intended to enhance investor protection.

## The separation of risk management and portfolio management

One of the most notable requirements associated with the Directive from a risk management perspective is that the AIFM

must ensure that the risk management and portfolio management functions are independent of one another.

And while AIFMs still have the ability to delegate their risk management or portfolio management activities under the Directive, it is important to note that they may not completely delegate both of these functions simultaneously – they must choose to delegate one or the other.

## A broad range of risks AIFMs need to manage

AIFs are exposed to a wide range of risks, including market risk, credit risk, business risk, counterparty risk and liquidity risk to name a few. It is the role of the AIFM's board to define the risk appetite for each of the funds the firm manages and to put in place the appropriate mechanisms to monitor these risks on a continual basis. The AIFM will need to consider the operational risk exposures of the AIFM as well, and align this with the capital and/or professional liability requirements of the Directive.

Given the liquidity challenges AIFs experienced during the financial crisis,

liquidity risk is one of the more high-profile risk categories that AIFMs will need to manage on an ongoing basis to ensure that each of their funds can meet their redemption requirements and obligations at all times.

It is also worth noting that the risk management functions and requirements for real estate and private equity funds will be much different than those for equity or fixed-income funds and will require a specialized approach for planning and implementation.

## Building a quality risk management framework

AIFMs looking to design and implement a robust and high-quality risk management framework as part of the AIFMD will need to first identify and qualify the risk landscape associated with each individual AIF (e.g. different investment strategies will lead to different risk profiles). Next, they will need to define the qualitative and quantitative risk appetite for each fund. As part of this approach, the AIFMs will use risk reports and 'dashboards' to monitor and compare actual risk to the pre-established appetite.

And finally, AIFMs will need to structure the appropriate mechanisms and monitoring systems as part of an ongoing risk management approach. AIFMs will need to demonstrate that they implement sufficiently strong risk management processes.

### Challenges and opportunities facing AIFMs

There are a number of challenges facing AIFMs as they prepare for these stringent, new requirements, including the need to establish comprehensive new processes, internal control mechanism and systems to continuously monitor a wide array of risks. These changes will also entail significant investment, which may ultimately be passed along, in one form or another, to the investors in the funds. Having said that, in what is an extremely competitive marketplace, there may also be opportunities for AIFMs that implement robust risk management frameworks to highlight their transparency and compliance with these rigorous requirements as a value added service and competitive differentiator.

## How KPMG can help ?

Risk management is a key pillar of the AIFMD for a number of reasons, including the fact that it is interconnected with so many other functions, including valuation, reporting and operations of the individual AIFs. KPMG has demonstrated expertise helping some of the world's largest and most prominent AIFMs prepare for this complex new regulatory regime, including the development of robust risk management frameworks, systems and processes to help monitor risks, maintain compliance with the new Directive and to allow investors to make informed risk and return decisions.

### Common AIFMD-related acronyms

<b>AIF</b>	Alternative Investment Fund
<b>AIFM</b>	Alternative Investment Fund Manager
<b>AIFMD</b>	Alternative Investment Fund Managers Directive
<b>ESMA</b>	European Securities and Markets Authority
<b>EU</b>	European Union
<b>FATF</b>	Financial Action Task Force
<b>MiFID</b>	Markets in Financial Instruments Directive
<b>MS</b>	Member State of the European Union
<b>MSR</b>	Member State of Reference for a non-EU AIFM
<b>UCITS</b>	Undertakings for Collective Investment in Transferable Securities

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