

INREV, AREF and BPF joint proposal on UK AIFMD External Valuer Liability



7 May 2021

We are sending this submission on behalf of the Association of Real Estate Funds (AREF), European Investors in Non-Listed Real Estate (INREV) and the British Property Federation (BPF), in the context of:

Article 19(10) of The Alternative Investment Fund Managers (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/328) (**UK AIFMD**).

“AIFMs are responsible for the proper valuation of AIF assets, the calculation of the net asset value and the publication of that net asset value. The AIFM’s liability towards the AIF and its investors shall, therefore, not be affected by the fact that the AIFM has appointed an external valuer.

Notwithstanding the first subparagraph and irrespective of any contractual arrangements providing otherwise, the external valuer shall be liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer’s negligence or intentional failure to perform its tasks.”

- Under this Article, an external valuer has unlimited liability to the AIFM for any losses suffered by the AIFM as a result of the external valuer’s negligence or intentional failure to perform its tasks.
- In the course of the legislative process for the 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 and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (**EU AIFMD**) and subsequently with EU AIFMD taking effect, we have urged reform of Article 19 (10) of EU AIFMD.

We suggest that in light of the EU-UK Trade and Cooperation Agreement of 24 December 2020 there is now the opportunity following the 31 December 2020 expiry of the UK Brexit transition period for the FCA and/or the UK Government to reform Article 19(10) of UK AIFMD. The wording of the Article in UK AIFMD – and in particular reference to “negligence” - follows the same wording contained in the EU AIFMD.

In relation to Article 19(10) of the EU AIFMD, there have been differing interpretations of what actions constitute “negligence” i.e. there is no harmonised standard across the EU interpreting the threshold for potential unlimited liability.

In the UK (and several other EU Member States), “negligence” (sometimes also called “simple negligence”) is interpreted to mean relatively minor mistakes, and is distinguished from “gross negligence” (often used as market parlance and meaning “serious error”), which is used to mean relatively more serious mistakes. As a result, in the UK, many real estate valuers - adopting professional guidelines from their industry body, the Royal Institution of Chartered Surveyors (RICS) - are unwilling to accept unlimited liability for “simple negligence”. They therefore refuse to accept the external valuer role for the buildings in real estate fund portfolios. This is unfortunate, as external

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valuers of real estate investments have long been a recognised and well-established means of ensuring that the valuation of property in funds is conducted according to industry standards by qualified, licensed independent third-parties.

Professional indemnity insurance in the UK is not available for unlimited liability related to actions deemed less than a serious error. As a result of Article 19(10) – for the purposes of EU AIFMD and (since 31 December 2020) UK AIFMD - many UK AIFMs have been forced to perform the valuation function in-house i.e., operate with internal valuations – rather than independent external valuations. This runs counter to long-established investor protection and good corporate governance practices and adds unnecessary costs.

From an EU perspective, we welcome ESMA's acknowledgement of the problem in Chairman Maijor's letter to Commission Executive Vice President Dombrovskis and their support of finding a solution to the external valuer liability issue for real estate funds. Although Chairman Maijor recommended a change to Level 1 text of AIFMD to raise the standard in Article 19(10) to "gross negligence", we, in our submissions to the EU AIFMD review (Public Consultation on the review of EU AIFMD issued 22 October 2020), are very reluctant to recommend opening up the Level 1 text of AIFMD for this single issue and believe it is actually not necessary. We suggested in our submissions that a Level 2 or Level 3 interpretation of Article 19(10) would establish a harmonised scope of coverage of the article across the EU. This could be accomplished by noting that, under Article 19(10): "the external valuer is subject to unlimited liability to the AIFM for any losses suffered by the AIFM only from the external valuer's serious error or intentional failure to perform its tasks."

In the context of the UK, we suggest there is no need for primary legislative reform of UK AIFMD for this single issue. Pending any primary legislative reform of UK AIFMD for this issue and other issues (i.e. justified on account of the combination of this and other issues), a pragmatic solution via an FCA consultation (and then guidance) that Article 19(10) of UK AIFMD should be interpreted on the basis that "the external valuer is subject to unlimited liability to the AIFM for any losses suffered by the AIFM only from the external valuer's serious error or intentional failure to perform its tasks."

We would like to engage with the FCA to find a solution to this much needed reform of Article 19(10) of UK AIFMD; we would welcome an initial meeting with yourselves to discuss this matter further.