

AIFMD Level 2
Extracts on
The necessity and importance of
Permanent Risk Management Function

1. The AIFM shall establish and maintain a permanent risk management function that shall:
 - i. implement effective risk management policies and procedures in order to **identify, measure, manage and monitor on an on-going basis all risks** relevant to each AIF's investment strategy, to which each AIF is or may be exposed;
 - ii. ensure that **the risk profile** of the AIF disclosed to investors in accordance with Article 23(4)c of Directive 2011/61/EU, is **consistent with the risk limits** that have been set in accordance with Box 29;
 - iii. monitor compliance with the risk limits set in accordance with Box 29 and **notify** the AIFM's governing body and where it exists **the AIFM's supervisory function in a timely manner when it considers the AIF's risk profile is inconsistent with these limits** or where it is aware there is a material risk that it will be inconsistent with these limits;
 - iv. provide the following **regular updates to the governing body of the AIFM** and, where it exists, the AIFM's supervisory function at a frequency which is in accordance with the nature, scale and complexity of the AIF and/or the AIFM's activities:
 - the consistency between and the compliance with, the risk limits set out in Box 29 (Risk Limits) and the risk profile of that AIF as disclosed to investors in accordance with Article 23(4)(c) of Directive 2011/61/EU; and
 - the adequacy and effectiveness of the risk management process, indicating in particular whether appropriate remedial measures have been or will be taken in the event of any actual or anticipated deficiencies; and
 - v. provide **regular updates to the senior management outlining the current level of risk** incurred by each managed AIF and any actual or foreseeable breaches to any risk limits set out in Box 29, so as to ensure that prompt and appropriate action can be taken.
2. The AIFM shall ensure that the permanent risk management function shall have the necessary authority and access to all relevant information necessary to fulfil the tasks set out in paragraph 1.

Explanatory Text

10. ESMA's advice on the role of the permanent risk management function is based on Article 12 of the UCITS implementing Directive (2010/43/EU); revisions have been made to this article to bring it into line with the terminology of the AIFMD and to make it relevant to the many types of AIFM/AIF that will fall under its scope. Specifically, this advice explains the tasks that should be undertaken by the permanent risk management function and that the function must have the necessary authority and access to information to fulfil those tasks.

- The policies and procedures implemented by the risk management function must be effective so that it can identify, measure, manage and monitor on an on-going basis all risks relevant to each AIF's investment strategy, to which each AIF is or may reasonably be exposed. ESMA does not consider that it is appropriate to advise the Commission which risks will be more or less relevant to specific strategies and in general many, if not all, risks will be relevant.
- This advice does not remove the responsibility of the governing body or senior management of the AIFM to set risks limits for the AIF. However, **ESMA considers that it is the responsibility of the permanent risk management function to ensure that those limits are in line with the risk profile disclosed to investors** in accordance with Article 23(4)c of Directive 2011/61/EU. ESMA recommends that setting risk limits in line with the strategy of the AIF is a framework that should be applied across all types of AIFM.
- ESMA considers that **once a risk framework has been constructed through the use of quantitative and/or qualitative limits the role of the permanent risk management function is to monitor compliance with those limits** and notify the governing body and, where it exists, the AIFM's supervisory function in a timely manner when it considers that there has been a breach. The form of notification is likely to vary according to the nature of the inconsistency.
- ESMA considers that the governing body of the AIFM should regularly receive certain pieces of information from the permanent risk management function:
The risk management function should provide information in relation to the consistency between the risk framework and the current risk profile of the AIF. This information may be useful for the governing body of the AIFM to identify when the AIF is close to breaching a particular limit, or how often it has breached limits in the past.
The governing body should also know:
 - **if the risk management procedures that have been put in place are effective and**
 - **if they have been demonstrated not to be effective what measures have been taken to rectify the situation.**In order for the risk management function to provide useful information in this regard, it may be necessary to **review the systems in place on a periodic basis.**
- The risk management function should be proactive and outline any actual or foreseeable breaches to senior management. **A necessary component of this may be portfolio stress tests to identify scenarios that would lead to breaches in limits.**

11. The governing body of an AIFM refers to the component of the governance structure with ultimate jurisdiction and power of direction. **In corporate structures this is usually the board of directors but in other structures may be an equivalent body. The governing body is distinct from senior management, whom it directs, but some or all members of senior management may comprise the governing body which may also contain non-executive members.**