

Regulatory News Alert

AIFMD II Proposal is out now!

The European Commission published its long-awaited draft to amend the Alternative Investment Funds Directive (AIFMD)

29 November 2021

Context and objectives

On 25 November 2021, as a 10th anniversary gift, the European Commission published a legislative proposal amending the [Alternative Investment Funds Manager Directive \(AIFMD—Directive 2011/61/EU\)](#) (“the Directive”).

If that were not significant enough, the European Commission also felt that several issues highlighted in the AIFMD review were equally relevant for UCITS. Consequently, to better align the AIFM and UCITS requirements, this **legislative proposal also amends the Undertakings for the Collective Investment in Transferable Securities Directive** ([UCITS—Directive 2009/65/EC](#)).

By way of this proposal, the European Commission intends to consider new market developments that have occurred since the Directive first entered into force. Therefore, it has suggested improvements that target the elements of the framework that were not sufficiently addressed when the Directive was first published.

The proposal’s key points are as follows:

Loan-originating AIFs

The European Commission proposes the establishment of **common rules for loan-originating AIFs**, to ensure that the European Union has a uniform level of investor protection. These rules will allow AIFs to develop their activities by originating loans in the European Union and facilitate access to finance by EU companies.

However, given the fast-growing private credit market, the potential micro risks and macro prudential risks that such AIFs could pose to the broader financial system must be addressed. Therefore, **lending** will be recognized as a legitimate activity of AIFMs, meaning AIFs could extend loans anywhere in the European Union, **including across borders**. These rules **will be harmonized** to improve risk management across the financial market and increase transparency for investors.

AIFMs managing AIFs that engage in lending activities, including purchasing loans on the secondary market, will need to implement **effective policies, procedures and processes for granting loans, assessing credit risk, and administering and monitoring their credit portfolios**, which should be reviewed periodically.

Only **close-ended fund structures** would be allowed for loan-originating AIFs, because these structures are not vulnerable to redemption demands and can hold originated loans to maturity.

Increased scrutiny over delegation arrangements

National competent authorities (NCAs) will provide the European Securities and Markets Authority (ESMA) with delegation notifications if an AIFM **delegates more of the AIF's portfolio management or risk management functions than it manages in-house to entities located in third countries**.

ESMA will develop **regulatory technical standards (RTS)** to specify the content, form and procedures to **standardize the notification process of AIFMs' delegation arrangements**. This form will indicate the activities that make up the **risk and portfolio management functions** to determine **whether an AIFM has delegated more functions than it has retained**.

The proposed amendments to the Directive will clarify that its **delegation rules apply to all functions listed in its Annex I** and the **ancillary services** referred to in Article 6(4).

Based on ESMA's input, the European Commission will **review the delegation regime** with a view to proposing the necessary amendments **to preclude the formation of "letterbox" entities**.

New additions to the list of "ancillary services"

To increase the efficiency of AIFM activities, the list of authorized ancillary services will be extended to include **benchmark administration** and **credit servicing**.

Level playing field with Markets in Financial Instruments Directive (MiFID) firms

AIFMs that provide ancillary services involving **financial instruments** (like discretionary portfolio management, DPM, investment advice, reception and transmission of orders, RTO, etc.) will be subject to the rules of Directive 2014/65/EU of the European Parliament and of the Council (MiFID II). Regarding other assets that are not financial instruments, AIFMs should comply with the Directive.

Minimum of two full-time, EU-based senior managers

When AIFMs apply for authorization, they should provide NCAs with information about the human and technical resources they will employ to carry out its functions and, where applicable, to supervise delegates.

At least two senior managers should be employed or conduct the AIFM's business **on a full-time basis** and **be resident in the European Union**. This is already enshrined in the Commission de Surveillance du Secteur Financier's (CSSF) circulars and current market practices.

Reporting requirements

The supervisory reporting template for AIFMs will be changed to **avoid duplicative reporting requirements** that exist under European Union and national legislation, in particular the European Market Infrastructure Regulation (EMIR) and the European Central Bank's regulations on statistical reporting.

The reporting scope could be broadened to include a **full portfolio disclosure** periodically, depending on how ESMA assesses this information's relevance.

ESMA will develop **RTS** that set out the content, form and procedures to **standardize the supervisory reporting process**, which will replace the reporting template laid down in the European Commission Delegated Regulation (EU) 231/2013.

Liquidity management tools (LMTs)

To ensure a more effective response to liquidity pressures in times of market stress and to better protect investors, new rules will implement the **European Systemic Risk Board's (ESRB) recommendations**.

Investors should be informed of LMTs' conditions of use.

ESMA will develop **RTS** to specify **the process for choosing and using LMTs**.

Depositary regime extended to central securities depositories (CSDs)

CSDs will be **included in the custody chain** when they provide custody services (in their investor CSD role) to AIFs to ensure that, in all cases, there is a **stable and consistent information flow** and more level playing field between the custodian of an AIF's asset and the depositary.

Given that authorized CSDs are already subject to stringent sectorial requirements and supervision, depositaries **are relieved from the requirement to perform ex-ante due diligence** where they intend to **delegate custody to CSDs**.

Provision of services by CSDs that act in the capacity of an issuer CSD **shall not be considered a delegation of the depositary's custody functions**.

No EU-wide depositary passport yet

Given the lack of EU harmonization of securities and insolvency laws, the European Commission ruled out introducing a **depositary passport** at this stage.

However, while the European Commission plans to further assess if it is appropriate to propose measures to achieve a more integrated market, new rules will allow NCAs to permit AIFMs or AIFs **to procure depositary services located in other Member States**.

Investor information

AIFMs should **identify fees** that will be borne by the AIFM or its affiliates, as well as **periodically report on all fees and charges** that are directly or indirectly allocated to the AIF or to any of its investments. AIFMs will also be required to report to investors regarding the **portfolio composition of originated loans**.

Third-country entities

Third-country entities with access to the internal market should not be established in jurisdictions identified as **high-risk countries** by the latest **European laws against money laundering**.

In addition, non-EU AIFs or non-EU AIFMs that are subject to national rules and active in individual Member States should meet the requirement that they are not located in a third country deemed **uncooperative in tax matters**.

Strengthened supervisory cooperation

If there are risks to financial stability, the **AIFM's host NCA may ask the AIFM's home NCA** to exercise its supervisory powers, specifying the reasons for its request and notifying ESMA and the European Systemic Risk Board (ESRB).

ESMA will develop **RTS** that indicate the situations in which **NCAs may exercise powers in relation to LMTs**.

Introduction of comparable rules for UCITS

The UCITS Directive will be amended to introduce the same regulatory requirements, specifically regarding **the delegation regime, the regulatory treatment of custodians, supervisory reporting requirements and the availability and use of LMTs**.

Next steps

At this stage, the laws are in draft form and will be further discussed and negotiated by the European institutions. Once the amended Directives are adopted, **Member States will have 24 months** to transpose and enforce the new rules.

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- CSSF license application
- IT strategy
- AIFM operating model definition
- Market research and analysis

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