UPDATE

AIFMD 2.0: European Commission Publishes Legislative Proposals

On 25 November 2021, the European Commission ("Commission") published its much-anticipated legislative proposals[1] (the "Proposals") to amend the Alternative Investment Fund Managers Directive ("AIFMD").

The Proposals form part of a legislative package[2] in which the Commission seeks to deliver on several key commitments in the EU's Capital Markets Union ("CMU") plan. The suggested changes cover key topics including delegation; liquidity risk management; loan origination; marketing and depositary services in the context of alternative investment funds ("AIFs").

The Proposals also contain changes to the UCITS Directive[3] to align delegation, liquidity risk management and regulatory reporting more closely with AIFMD, where the focus of this update is on the proposed AIFMD changes.

Delegation

Importantly, the Proposals do not set out any fundamental changes to the existing AIFMD delegation framework. Rather, the emphasis is on strengthening supervisory oversight to ensure a more level playing field in how the current delegation rules are applied.

Specifically, the Proposals introduce a reporting regime where all EU national competent authorities ("NCAs") would be obliged to report annually to ESMA any instances where alternative investment fund managers ("AIFMs") which they regulate are delegating more portfolio management or risk management functions to entities located in non-EU countries than they are retaining.

Secondly, it is proposed that applications submitted to NCAs for authorisation as an AIFM should provide information on the human and technical resources that the AIFM will employ to carry out its functions and, where applicable, supervise its delegates. Additional information would also be required on the intended extent of delegation and sub-delegation and the resources "*to be used by the AIFM for monitoring and controlling delegates*".

It is also proposed that every AIFM must have at least two full-time staff resident in the EU. In practice, this should have no impact on Irish or Luxembourg authorised AIFMs, which are already subject to clear and comprehensive local regulatory 'substance' requirements.

The Proposals further extend the scope of the AIFMD delegation requirements to capture not only the delegation of regulated activities under Article 20, but also the delegation of Annex I functions and Ancillary Services (as defined below).

Finally, the Proposals task ESMA with reviewing the effectiveness of the AIFMD delegation regime at least every two years.

[1] https://ec.europa.eu/transparency/documents-register/detail?ref=COM(2021)721&lang=en

[2] https://ec.europa.eu/commission/presscorner/detail/en/IP_21_6251

[3] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A02009L0065-20140917

Liquidity Risk Management

The Proposals provide for a more harmonised approach to liquidity risk management across the EU, by requiring AIFMs managing an open-ended alternative investment fund to be able to (a) temporarily suspend repurchase or redemption of the AIF's units and (b) choose at least one other appropriate liquidity management tool ("LMT") from a prescribed list (e.g. gating, notice periods, side pockets etc.).

The Proposals require AIFMs to notify their NCAs "*without delay*" of the activation / deactivation of any LMT (and NCAs must, in turn, notify the host NCA(s) and the EU supervisory authorities).

Interestingly, it is also proposed to empower NCAs to require AIFMs to activate / deactivate LMTs "*in the interest of investors or of the public*". Somewhat controversially, ESMA would also be empowered to require (a) non-EU AIFMs marketing AIFs in the EU and / or (b) EU AIFMs managing non-EU AIFs to activate / deactivate LMTs.

This extra-territorial scope is particularly notable, as it purports to directly impact the functioning of non-EU AIFs and AIFMs.

Loan Origination

Citing regulatory fragmentation in the private credit markets, the need to react to market-wide effects and to promote an efficient internal market, the Commission proposes to introduce a new specific regime for AIFMs managing loan-originating AIFs ("LOAIFs")[4].

Such AIFMs would be required to implement (and annually review) policies and procedures for granting credit, credit risk assessment and administering / monitoring the credit portfolio, and ensure:

- That any loan to a single financial undertaking[5] or a fund borrower does not exceed 20% of the LOAIF's capital;
- The LOAIF does not lend to the AIFM, its staff, the depositary or a delegate of the AIFM (e.g. an investment manager); and
- The LOAIF retains 5% of the notional value of loans originated by it and subsequently sold.

To mitigate the risk of liquidity mismatches, it is also proposed that a LOAIF must be closed-ended if the notional value of its originated loans exceeds 60% of its net asset value. In an Irish context, the Central Bank of Ireland's existing regime for Loan-originating Qualifying Investor AIFs ("LQIAIFs") already addresses the same policy concerns (i.e. liquidity mismatch, minimum diversification, related party lending) through very similar regulatory requirements.

In some respects, though, the Irish regime is even more onerous than the Proposals (for example, LQIAIFs must be closed-ended without exception, and are subject to a maximum leverage / exposure limit). So in light of the Proposals' policy goal to achieve a harmonised pan-EU loan origination fund regime, it will be interesting to see if and to what extent the Irish regime will need to adapt to align with the Proposals.

Marketing of Non-EU AIFs

The existing AIFMD framework enables the marketing of AIFs domiciled in non-EU jurisdictions to EU-based professional investors on a private placement basis under local EU member state requirements. This is commonly referred to as the National Private Placement Regimes ("NPPRs").

Currently, marketing through NPPRs is not permitted for AIFs domiciled in jurisdictions on the Financial Action Task Force ("FATF") "Call

[4] Note the investment restrictions in the Proposals are without prejudice to applicable limits for ELTIFs, EuVeca or EuSEF funds

[5] As defined in Solvency II, primarily being an entity authorised to provide a regulated financial service in the EU such as credit institutions,(re-) insurers, MiFID firms

for Action" or "Non-Cooperative Jurisdiction" list.

Under the Proposals, this FATF condition would be replaced with new conditions prohibiting the marketing of AIFs from jurisdictions that are either: (i) on the EU's list of high-risk countries according to the latest EU AML rules and / or (ii) on the EU's list of "non-cooperative" jurisdictions for tax purposes.

Depositaries

Central securities depositaries ("CSDs") are not currently deemed to be delegates of AIF depositaries, which the Commission believes can prevent depositaries from performing oversight properly in the absence of a stable flow of information. It is therefore proposed to include CSDs in the custody chain[6], albeit that as they are already regulated, there would not be the usual requirement for full due diligence.

Where a depositary based in a third country is permitted, it is proposed to update the criteria that must be met, on the same terms as set out in the "Marketing of Non-EU AIFs" section above.

Miscellaneous

Scope of AIFM Permitted Activities

In addition to managing AIFs and the ability to provide certain ancillary 'MiFID' add on services[7], the Proposals add two services to the list of services that an AIFM may perform:

- Benchmark administration under Regulation (EU) 2016/1011[8]; and
- Credit servicing under a new directive which is in progress under CMU (together with the 'MiFID' add on services, the "Ancillary Services").

The Proposals also envisage the list of AIFM functions in Annex I of AIFMD being expanded to add:

- Lending; and
- Servicing of securitisation special purpose entities.

Investor Disclosures

It is envisaged that the list of mandatory pre-contractual disclosures (i.e. "Article 23" information) would be expanded to cover:

- The description of each AIF's liquidity risk management to include relevant LMT details; and
- Additional disclosure of AIF fees borne by the AIFM / its affiliates.

Amendments are also proposed to AIFMs' ongoing periodic disclosure to investors, including new requirements to disclose:

- The composition of any originated loan portfolios;
- All direct and indirect fees and charges directly or indirectly charged or allocated to the AIF or to any of its investments (quarterly); and
- Any parent / subsidiary / special purpose entities established regarding investments of the AIF (quarterly).

Regulatory Reporting

It is proposed to increase AIFMs' regulatory reporting obligations to NCAs, moving from reporting on *main* instruments and *principal* exposures to simply 'instruments' and 'exposures'. ESMA would therefore need to update its current 'Annex IV' reporting template.

[6] Unless acting in capacity as issuer as defined in Article 1, point (e) of Commission Delegated Regulation (EU) 2017/392

[7] Individual portfolio management (e.g. segregated mandates), investment advice, safe-keeping and administration regarding units in funds and reception / transmission of orders in relation to financial instruments

[8] https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32016R1011

Next Steps

The Proposals are still at an early stage. They will now be considered by the European Council and the European Parliament and it is anticipated that agreement could be reached by midto end-2022.

The Proposals take the form of an amending directive – meaning that, after formal adoption and publication in the Official Journal of the EU, each EU member state will be given time (provisionally up to two years) to individually transpose the new rules into national law. So although EU member states could elect to implement earlier, the rule changes may not be fully in effect until late 2024 or early 2025.

The Maples Group has significant experience in advising the world's leading AIFMs in the structuring, establishment and distribution of their AIFs. In particular, our expertise covers many of the core areas of focus of these Proposals including delegation, loan origination and marketing. In addition, our global network of offices gives us informed local perspectives on how these proposals will affect EU AIFMs, non-EU AIFMs and groups operating both inside and outside the EU.

Our global AIFMD advisory teams will be working closely with our clients, their international advisers, industry associations, regulators and governments as these Proposals advance and will be providing regular updates.

Further Information

For further information, please liaise with your usual Maples Group contact or any of the persons listed below.

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