

AIFMD revamp on track as European Commission presents Capital Markets Union Action Plan

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Six years after the publication of its first Action Plan, the European Commission (the **Commission**) presented on 25 November 2021 a package of reforms within the framework of its Capital Markets Union (**CMU**) Action Plan.

Containing four legislative proposals, the Action Plan not only brings changes to the AIFMD, [1] but it also aims to modify the existing UCITS [2] and ELTIF [3] regimes, amending transparency rules under MiFIR [4] and introducing the European single data access point for investors. The legislative package is aligned with the overall CMU strategy to continue building an internal market for financial services and making financing more accessible to European companies, while strengthening investors' protection.

In this briefing, the first in a series focusing on the Commission's proposals, we will cover the proposed amendments to the AIFMD and UCITS regimes; these amendments aim to establish harmonised rules in certain areas for both AIFs and UCITS.

| Core changes specifically related to the AIFMD

Loan origination

The AIFMD revamp (**Proposed New Directive**), along with the recognition of lending as a legitimate activity for loan originating funds, imposes new minimal requirements for AIFMs managing AIFs engaging in lending activities, that include the following:

- Risk management – implementation, maintenance and periodic review of effective policies, procedures and processes for the granting of credit, for assessing the credit risk and for administering and monitoring their credit portfolio.

- Borrower exposure limits – a loan originated to a single borrower which is a financial undertaking or a collective investment undertaking [5] must not exceed 20% of the AIF's capital [6] (notwithstanding particular ELTIF/EuVECA [7]/EuSEF [8] limitations).
- Borrower restrictions and conflicts of interest – loan granting is forbidden to the AIFM, the AIFM's staff, the depositary or the delegates or their staff.
- Interest retention – to avoid the situation where the loan is originated with the sole purpose of selling it, the AIFM must ensure that the AIF retains, on an ongoing basis, 5% of the notional value of the loan it has granted and subsequently sold off (unless the loan is purchased on the secondary market).
- Closed-ended structure – loan originating funds whose notional value of the loans originated exceeds 60% of their net asset value will have to be structured as closed-ended (again notwithstanding particular ELTIF/EuVECA/EuSEF limitations).

Other permitted core and ancillary activities:

In addition to loan origination performed by AIFs, it is proposed to extend the list of eligible activities which may be provided by AIFMs to include servicing of securitisation special purpose vehicles. In case of a so called "MiFID top-up" license, additional ancillary services will be permitted such as benchmarks administration and credit servicing. In that regard, clarifications were provided in the applicable MiFID [9] provisions.

Depositaries

To address the lack of competitive supply of depositary services observed on certain national markets, it is proposed that Member States will have the possibility to allow procurement of depositary services on a cross-border basis. New provisions have been added to provide for cooperation of the depositary with its own home regulator, as well as with the competent authorities of the AIFM and the AIF, to increase supervisory reach.

Conditions for the appointment of a depositary established in a third country have been changed to exclude those established in a high-risk country listed in the EU Council's list of non-cooperative jurisdictions for tax purposes (**EU Council List**), instead of the FATF List of Non-Cooperative Territories (**FATF List**) which is currently referenced.

Last, but not least, it is worth noting that although the option of introducing a depositary passport has not been retained so far, the Commission shall assess the appropriateness of introducing a depositary passport within five years following the entry into force of the Proposed New Directive.

Third country marketing

Marketing of non-EU AIFs managed by an EU AIFM with or without a passport, marketing with a passport of a non-EU AIF managed by a non-EU AIFM, authorisations of non-EU AIFMs to manage and/or market AIFs in the EU, marketing without a passport of AIFs managed by a non-EU AIFM, will be subject to altered conditions. These conditions have been changed to exclude third countries where the AIF is established in a high-risk country under the 5th EU Anti-Money Laundering Directive [10] (AMLD5). As this criteria previously was linked to the FATF List, this effectively means that the EU Council List will effectively replace the FATF List.

Disclosures to investors

As regards investor protection, it is proposed to strengthen transparency towards investors by enhancing investor disclosures (i) before they invest and (ii) on a periodic basis.

Pre-contractual disclosures will have to include:

- a description of the AIF's liquidity risk management, including inter alia the redemption rights both in normal and in exceptional circumstances, the possibility and conditions for using selected liquidity management tools and the existing redemption arrangements with investors; and
- a list of fees and charges in connection with the operations of the AIF that will be borne by the AIFM or its affiliates;

while the periodic reports will comprise the following additional disclosures:

- the composition of the originated loan portfolio;
- a quarterly update on all (in)direct fees charged or allocated to the AIF or its investments; and
- a quarterly update on any parent companies, subsidiaries and special purpose entities established by the AIFM, the AIFM's staff or its affiliates in relation to the AIF's investments.

Core changes applying to both AIFMD and UCITS Directive

Delegation

The proposal clarifies that all activities listed in Annex I of the AIFMD and in Annex II of the UCITS Directive may be delegated by the investment fund manager (IFM), ie the AIFM or a UCITS Management Company, notwithstanding limitations provided for in the AIFMD Delegated Regulation regarding letter-box entities.

Besides informing the home state regulator of the objective reasons of the delegation

arrangements, where a EU-IFM delegates to a third-country entity more portfolio management or risk management functions than it retains, the competent authorities shall be required to notify ESMA annually of said delegation arrangements.

A peer review of the national competent authorities' supervisory activities regarding delegation to third-country entities will be carried out by ESMA on a biannual basis. Details of the notification processes will be laid down by a specific delegated act containing regulatory technical standards adopted by the EU Commission.

Liquidity management

It is proposed to harmonise rules of liquidity management for open-ended AIFs and UCITS by providing a list of minimum liquidity management tools (**LMT**) comprising redemption gates, notice periods, redemption fees, swing pricing, anti-dilution levy, redemptions in kind and side-pockets. Besides the ability to suspend redemptions and subscriptions, Member States will have to ensure that, following a suitability assessment against the proposed investment strategy, IFMs will be able to select at least one additional LMT from the list.

Activation or deactivation of a particular LMT will have to be notified by the IFM to the home regulator. In the interest of investors, competent authorities will be allowed to force the IFMs to (de)activate a LMT. This includes non-EU AIFMs that are marketing in the Union AIFs that they manage or EU AIFMs managing non-EU AIFs.

Finally, ESMA will be in charge of developing regulatory technical standards specifying characteristics of the LMTs, the use of selection criteria and suitability assessments, as well as appropriate disclosures to investors.

Custodians

Currently, issuer central securities depositories (**CSDs**) and investor CSDs are not considered delegates of the depositary. This situation undermines the ability of depositaries to have access to the information needed to effectively perform their oversight duties. Consequently, it is proposed to include investor CSDs into the custody chain. With respect to issuer CSDs, these will not be considered as delegates in relation to the depositary's custody function, and furthermore, the obligation for the depositary to perform an ex-ante due diligence will, in that case, be waived, as it is considered that issuer CSDs have been sufficiently vetted when seeking to be authorised as such.

Substance / Authorisation

When applying for an authorisation, IFMs will be required to provide the following information to the competent authorities of the home Member State:

- information about the persons effectively conducting the business of the IFM (role

description, seniority, responsibilities and time allocation);

- the identities of shareholders who have qualifying holdings;
- the organisational structure;
- the remuneration policies; and
- information on (sub)delegation arrangements and human and technical resources used for delegate oversight.

Additional requirements on substance are also introduced regarding the residence and number of persons who effectively conduct the business of the IFM – besides the need to be of sufficiently good repute and sufficiently experienced, the granting of an IFM licence is conditional upon the appointment of at least two natural persons residing in the EU, who are either employed full-time or who are committed full-time to conduct the IFM's business. From a Luxembourg perspective, these requirements are in line with those laid down by the CSSF Circular 18/698 of 23 August 2018, which imposes substance and governance conditions on Luxembourg domiciled IFMs.

Supervisory powers

A novelty in the supervisory convergence is the possibility for the competent authorities of a host Member State to address a reasoned request to the home Member State of the IFM in order to take supervisory actions against said IFM and to notify ESMA and the ESRB, if that situation may affect investors protection and financial stability.

The above proposals will further undergo scrutiny by the EU Parliament and the Council, within the ordinary legislative procedure. Once adopted, the directive's transposition deadline is envisaged to be twenty-four months after its entry into force. Taking into account the length of the legislative process and the fact that it can take up to several years, we estimate these obligations might be transposed in the Luxembourg legislative framework in 2025.

[1] Alternative Investment Fund Managers Directive (AIFMD 2011/61/EU)

[2] Undertakings for Collective Investment in Transferable Securities (UCITS Directive 2009/65/EC)

[3] European Long-Term Investment Funds (ELTIF Regulation 2015/760/EU)

[4] Markets in Financial Instruments Regulation (MIFIR Regulation 600/2014/EU)

[5] Financial undertaking within the meaning of article 13(25) of UCITS Directive or collective

investment undertaking within the meaning of article 4(1), point (a) of the Proposed New Directive or within the meaning of article 1(2) of UCITS Directive

[6] It is worth noting that the concept of AIF's capital is not defined

[7] European Venture Capital Funds (EuVECA Regulation 345/2013)

[8] European Social Entrepreneurship Funds (EuSEF Regulation 346/2013)

[9] Markets in Financial Instruments Directive (MIFID II 2014/65/EU)

[10] Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU

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