

Clients & Friends Memo

The European Commission Publishes a Consultation on the Review of the AIFMD

11 November 2020

On 22 October 2020, the European Commission (the **Commission**) published a public consultation (the **Consultation**) on the review of Directive 2011/61/EU on Alternative Investment Fund Managers (**AIFMD**).

Market participants are invited to reply via an online questionnaire by 29 January 2021. Based on the Consultation and other meetings with stakeholders, the Commission plans to publish a legislative proposal to amend the AIFMD in Q3 2021.

Background

Article 69 of AIFMD requires the Commission to review the application and the scope of AIFMD. The Consultation follows on from an assessment published by the Commission in June 2020 on whether the rules of the AIFMD are effective, efficient, coherent and relevant. Among other issues, the Commission identified the “gold-plating” of AIFMD requirements through national private placement regimes (**NPPRs**) as being a barrier to the efficient use of the marketing passport, while also highlighting the need for greater harmonisation in disclosure standards and in relation to standards applicable to different types of AIFs (such as those which originate loans, or private equity fund structures).

The Consultation also takes place in the context of concerns expressed by the European Securities and Markets Authority (**ESMA**) in August 2020 regarding the delegation of asset management activities under AIFMD regime to non-EU managers (a practice which is relatively common across the industry)¹. In a letter to the Commission on the AIFMD review, ESMA recommended possible legislative changes to provide clarification on the maximum extent of delegation permitted, to ensure supervisory convergence on the issue and to ensure authorised AIFMs maintain sufficient

¹ Letter from ESMA to the European Commission, 18 August 2020, available [here](#).

substance in the EU. This area is particularly sensitive because of the likely increase in delegation activity from the EU firms to non-EU (i.e. UK) firms after Brexit.

The Consultation covers the following areas:

- The functioning of the AIFMD regulatory framework, scope and authorisation requirements;
- Investor protection;
- International relations;
- Financial stability;
- Investing in private companies;
- Sustainability and Environmental, Social and Governance (**ESG**) issues; and
- Miscellaneous questions, including those on the powers of national regulators and enforcement practices.

Key Issues in the Consultation

The functioning of the AIFMD regulatory framework, scope and authorisation requirements

This section of the Consultation seeks comment on potential improvements to the AIFMD legal framework to facilitate further integration of the EU AIF market, in particular in relation to the operation of the AIFMD marketing passport. A number of questions focus on the level playing field between AIFMs and other financial intermediaries and whether the scope of the AIFM licence and permitted activities should be better aligned with other investment firms (in particular in relation to own account activities). The Commission is open to AIFM capital requirements becoming more proportionate with their risk profile, which would be an encouraging development for smaller firms.

Notwithstanding the current implementation of the Cross-border Distribution Directive EU/2019/1160 and Cross-border Distribution Regulation EU/2019/1156 by EU member states, which should be implemented by 2 August 2021, the Commission remains open to further views on how to make the AIFM passport more effective. The Consultation also asks for comments on whether the restrictions applicable to marketing by “small AIFMs” under the AIFMD should be loosened and why the EuVECA regime, designed to allow a passport for small venture capital firms, has not succeeded and firms feel forced to opt into the AIFM regime to target appropriate strategies.

Interestingly the Commission also seeks views on whether more needs to be done to exclude securitisation vehicles from the AIFMD regime to avoid the risks of regulatory arbitrage.

Investor protection

Under this heading the Commission seeks views as to whether there should be more harmonisation of AIFs that can be marketed to retail investors (currently at the discretion of individual member states). Whilst not explicitly linked, the Commission is also currently [consulting](#) on how to improve the ELTIF regime², which was designed to create long-term, closed-ended AIFs suitable for retail which would make equity and/or debt investments in transport and social infrastructure projects (energy, hospitals, social housing) as well as venture capital. To date, the ELTIF regime has not really caught on to any substantial degree.

In relation to hedge funds, the Commission also questions whether the rules around prime brokers need improvement, whether more explicit regulations are required around tri-party collateral management and the desirability of a depositary passport.

Real estate asset managers in particular will be interested to note the re-opening of the debate in relation to external valuers, which has proved a thorn in the side of the industry in terms of the liability external valuers are expected to bear.

Of key interest to both EU and non-EU managers (given the need to comply under national private placement regimes), the Commission is interested in views as to whether the investor reporting regime, both prior to investment and ongoing through the annual report, is suitable and how to improve it. One area they are focused on is additional ESG reporting – see below).

International relations

The Consultation seeks views on whether the current permission for non-EU AIFMs to market funds in the EU under NPPRs allows for a level playing field as between non-EU AIFMs and EU AIFMs. The clear implication in the Consultation, and previous statements from ESMA and the Commission, is that the Commission believes the NPPR regime creates an uneven playing field, at least by those member states that implement the regime without further gold plating.

In addition, the Consultation seeks views through a number of questions about delegation by EU AIFMs to managers outside of the EU, with the Commission specially asking whether the delegation rules are sufficiently clear to prevent the creation of “letterbox entities” in the EU. Legislative amendments are suggested to address this risk, including the introduction of quantitative criteria in relation to delegation, and/or rules providing for a list of core or critical functions that would have to be provided by the EU AIFM internally. In addition, the Consultation suggests that AIFMD

² Deadline for responses to the consultation is 19 January 2021.

standards could be applied to delegate non-EU managers where portfolio management has been delegated.

As well as with the investor disclosure regime, this will be the area of most immediate interest to non-EU managers that currently market into the EU, as well as the swathe of UK based managers who are about to become non-EU managers for the first time. From the perspective of U.S. or Asian based managers, further restrictions on delegation are likely to be viewed as extremely unwelcome. We also expect the EU industry associations to lobby hard that proper enforcement of the existing position should be quite sufficient.

Financial stability

The Commission notes that many investment funds are exposed to the leveraged loan and Collateralised Loan Obligations (**CLO**) markets. In order to assess risks to the financial stability and regulatory implications associated with leveraged loans and CLOs, the Commission suggests in the Consultation that more detailed and granular data on the involvement of AIFs in this market should be collected.

The Commission asks for feedback on the issues and legislative proposals in this area, including:

- adding additional data fields to the supervisory reporting templates to capture information about an AIF's exposures to leveraged loans and the CLO markets;
- whether a change to the current gross and commitment leverage calculation methods in regulatory reporting is appropriate and whether there should be greater use of VaR reporting;
- the harmonisation of leverage calculation methods for AIFs and UCITS;
- whether the powers of national regulators to cap leverage should be increased; and
- suggestions for the harmonisation of requirements for loan originating AIFs at an EU level, including restrictions so that only close-ended AIFs could originate loans and/or limiting interconnectedness with other financial intermediaries.

Investing in private companies

Currently AIFMD contains certain restrictions around acquiring control of private companies to prevent "asset stripping" and the Commission is seeking views about whether these rules are considered adequate or could be improved.

Sustainability and ESG issues

As noted in previous Clients & Friends memoranda, [EU Parliament Adopts Sustainability Taxonomy Regulation to Fight Greenwashing](#), [European Commission Consultation on the Renewed Sustainable Finance Strategy](#) and [Overview of the European Sustainability Taxonomy Regulation](#), the EU is bringing forward a wide range of legislative measures as part of its Action Plan on Sustainable Finance. In the asset management space, two Regulations are key in this regard: Regulation (EU) 2019/2088 (**Disclosures Regulation**) and Regulation (EU) 2020/852 (**Taxonomy Regulation**). These Regulations will require AIFMs to make entity and fund level disclosure about their approaches to sustainability and ESG issues. In particular, under the Disclosures Regulation AIFMs will have to take into account sustainability risks and adverse impacts of their investment decisions on sustainability factors in their due diligence policies and processes. The Consultation seeks comment on how these requirements should be integrated into any future amendments to AIFMD, for example, whether AIFMs should have a specific requirement to take account of the long term sustainability and social impacts of their investment decisions and whether AIFMs should have to integrate an assessment of principle adverse sustainability impacts into their investment decision processes.

In this section, the Commission acknowledges that the regulatory technical standards under the Disclosure Regulation and the Taxonomy Regulation are not yet in place (meaning market participants do not yet have a full view of their disclosure and product description obligations), but it is clear that there is intent from the Commission to integrate ESG matters fully into the revised AIFMD, rather than relying only on ESG specific legislation.

Conclusion

We expect industry associations to lobby quite strongly not to reopen the Level 1 text of AIFMD but rather to push for the refining of the regulations through secondary legislative measures and ESMA guidance, which should help head off some of the more controversial measures being consulted on. For example, the final section of the consultation consults on various miscellaneous issues, of which empowering ESMA to supervise all AIFMs, or perhaps only non-EU AIFMs marketing into the EU, and enforce many AIFMD requirements at the expense of national regulators stands out. The Commission makes it clear that, whilst the paper provides indications of the approach the Commission will take, it does not include final policy positions. It is unlikely that the Commission agree with all the suggestions proposed by ESMA in their letter from 18 August 2020 (see above) but much may still depend on the weight of responses the Commission receive.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys:

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