

Insights

EUROPEAN COMMISSION'S REVIEW INTO AIFMD

16 June 2020

SUMMARY

The European Commission has published its long awaited report into the application and scope of AIFMD. The report is generally positive and concludes that overall AIFMD has been successful in meeting its objectives. However, the report does highlight some areas in which amendments would be welcome or have been suggested by stakeholders. We provide a summary of its findings, as well as a brief Brexit update.

Background

On 10 June 2020, the European Commission (the Commission) published its report assessing the application and scope of the Alternative Investment Fund Managers Directive (AIFMD). AIFMD was adopted as a response to the global financial crisis and seeks to 'achieve a coherent supervisory approach to the risks of the financial system, to provide high level investor protection and to facilitate EU AIF market integration'.

The report was prepared in accordance with Article 69 of AIFMD, which required the Commission to review AIFMD, with an emphasis on the experience acquired in applying AIFMD. In preparing the report, the Commission aims to assess the impact of AIFMD on investors, alternative investment funds (AIFs), alternative investment fund managers (AIFMs) both in the EU and in third countries in order to establish the extent to which the objectives pursued by AIFMD have been achieved.

As part of its review, the Commission drew on the findings of the KPMG report that it commissioned in 2017 and also feedback from other stakeholders including ESMA and the European Systemic Risk Board (ESRB).

Findings

The findings of the report do not really highlight anything new and confirm that in general AIFMD has met its objectives in improving the monitoring of risks to the financial system and the cross-border raising of capital for investments in alternative assets. Similar themes to those highlighted in

the KPMG report are reiterated as being potential areas for future reform including: (i) the uneven interpretation and implementation across the EU; and (ii) the potentially excessive and duplicative disclosure requirements that currently apply.

The Commission is still considering the need for further proposals in this area and so it will be interesting to see if and when the Commission will put forward any suggested amendments to AIFMD. Given the political climate and the continuing delays to the AIFMD review process, it is unlikely that the AIFMD II process will be launched with particular urgency. Indeed, given that the Commission highlights the need to consider the interaction of AIFMD with other relatively new EU legislative steps (such as the Cross-Border Fund Distribution of Investment Funds), it may be that the status quo remains for the time being. We have set out below the principal points of interest arising from the report, both positive and constructive.

AIFMD led to less choice in retail market

The report notes that the AIFMD marketing passport is limited to targeting professional investors, which in turn has limited the cross border activities of AIFMs who are looking to approach semi-professional and retail investors and are therefore required to comply with varying and restrictive requirements.

However, given the AIF distribution is subject to the MiFID II regime, the Commission notes that the interaction between AIFMD and MiFID II would need to be considered before any amendments to the definitions of the types of investors in AIFMD are suggested.

Limitations for Small AIFMs

The Commission highlights one of the known deficiencies of AIFMD being that small AIFMs are often unable to comply with all the requirements of AIFMD and are therefore restricted in their ability to raise capital unless they can overcome significant barriers to market access. This is of course, only really an issue for those small AIFMs looking to access investors in one or more of the more restricted jurisdictions in relation to the National Private Placement Regime (NPPR). Otherwise, the small AIFM regime enables managers to benefit from a lighter touch form of regulation.

Marketing passport

The report credits the AIFMD passport with playing an important role in increasing access to national markets and also doubling the cross border distribution of AIFs. However, the report echoes the findings of the KPMG report and notes that the efficacy of the EU AIFMD passport is limited due to the inconsistent application of the AIFMD marketing rules, coupled with additional national requirements.

The Commission provides no further clarity on whether the marketing passport will be extended to third country firms. The existing frustrations in relation to the NPPR are noted in the report, which acknowledges that the uneven implementation has led to an un-level playing field between EU and non-EU AIFMs. The report notes that there have been differing suggestions with how to remedy the situation, with some member states suggesting further harmonising the NPPRs, and others who consider activating the AIFMD passport for third countries and phasing out the NPPRs to be a better solution. However, no formal proposal has been put forward in respect of this. We consider that the preferred option would be to retain the NPPR framework, even if the non-EU third country passports are introduced, as it would ensure that managers are given the option to market in the most efficient way possible for them.

Streamlined reporting at NCA level

The report confirms the need for supervisory reporting requirements in order to enable National Competent Authorities (NCAs) to monitor risks to the financial system across sectors and borders. However there is an acknowledgement that these need to be streamlined, whilst also considering the sunk costs already incurred by compliant AIFMs. The Commission also recognises that many AIFMs are subject to overlapping regulatory reporting requirements and therefore this could support the case for amending the current reporting template.

Brexit update

Brexit has been creeping back onto the agenda as the 30 June 2020 deadline rapidly approaches. By this date, in theory, the EU and the UK should have endeavoured to have completed equivalence assessments. It was also the deadline for deciding whether or not there would be a one-off one or two year extension of the transition period - although the UK has now firmly ruled this out. However, the likelihood is that the month end will pass without note, instead shifting focus to any progress being made in time for the 15-16 October 2020 European Council meeting.

In the meantime, firms will want to consider fine-tuning their existing plans and arrangements to be ready for 31 December 2020 when the transition period ends. We have set out 3 key updates below in terms of a no deal scenario.

- Many cross-border activities of third country firms, specifically delegation and marketing, require regulatory co-operation agreements to be put in place. In the absence of these co-operation agreements, UK managers would not be permitted to act as delegated portfolio managers of EU AIFs (a central plank of many contingency plans) or register for marketing into EU27 member states under the Article 42 NPPRs. Memoranda of Understanding between the FCA, ESMA and EU regulators to allow co-operation and exchange of information were agreed in February 2019 and are expected to be in place in time for 31 December in the event of a hard Brexit. It is hoped that ESMA will provide confirmation of this by way of update and to reassure firms of this critical plank of their no deal planning.

- For EU27 firms and funds providing services or marketing funds into the UK post a no deal Brexit, a Temporary Permissions Regime has been established, to last for a maximum of 3 years. The FCA intends to re-open the notification window by the start of Q4 to allow additional notifications to be made by firms and fund managers before the end of the transition period and to update their previously submitted notifications, if necessary.
- A patchwork of temporary measures was introduced by some EU27 member states to grant reciprocal access arrangements and allow access relief for UK firms doing business in the EU27 market. However, these arrangements must now be checked and stress-tested as some member states have changed their approach since putting measures in place, and the temporary relief firms are seeking to rely on may no longer be available.

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