

## Insights

# EUROPEAN COMMISSION CONSULTS ON AIFMD: THE LONG LIST

26 October 2020

## SUMMARY

The European Commission (the Commission) has published its long-awaited Consultation on AIFMD. It covers a range of subjects, under the broad headings of authorisation/scope, investor protection, international relations, financial stability, investment in private companies, sustainability/ESG and miscellaneous. Crafted as a series of questions, in both multiple choice and open format (including an invitation to suggest alternative policy options and raise other issues not addressed in the Consultation), it is difficult to gauge the Commission's view on specific amendments. Therefore, what is key is for stakeholders, individually or via industry bodies, to help determine how a proposed AIFMD II will take shape – by engaging in the feedback process and responding to the Consultation. The deadline for responses is 29 January 2021 and draft legislation is expected to follow in Q3 2021.

We have set out some background to the Consultation and highlighted some of the areas covered that we think are likely to cause the biggest impact in the funds arena.

## Background

A few points of context for the Consultation are set out below.

- It follows the Commission's 10 June 2020 report assessing the application and scope of AIFMD. This 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 aimed 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 feedback from other stakeholders, including ESMA and the

European Systemic Risk Board (ESRB).

- Although not explicitly referred to in the Consultation, some aspects are likely to have been influenced by ESMA's 19 August 2020 letter, which recommended various changes to AIFMD pending the Commission's review. See [our update briefing here](#) in which we flag the principal proposals. The funds industry will be pleased that some of the more controversial proposals in ESMA's letter are left unmentioned in the Consultation (such as more scrutiny of host AIFM models, that all functions listed in Annex 1 to AIFMD are covered by the delegation rules and clarification of the joint venture definition).

We have set out below some of the key areas of focus in the Consultation.

### **Eliminating alleged barriers for sub-threshold AIFMs**

The Commission's questions raise 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.

### **Supporting competitiveness and enhancing cross-border marketing and investor access**

The Consultation raises the functioning of the EU AIFMD passport, whose competitiveness can be limited due to the inconsistent application of the AIFMD marketing rules, coupled with additional national requirements. No proposals are put forward, and no mention of the marketing passport extension to third country firms. Our view remains 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.

### **Improving AIFM access to retail investors**

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 that AIF distribution is subject to the MiFID II regime, the Commission refers to the recent public consultation on MiFID II that has to be considered alongside any amendments to the definitions of the types of investors in AIFMD.

### **Tightening of delegation rules**

The Commission draws attention to various aspects of the delegation rules, including the extent that they ensure effective risk management, prevent letter box entities and provide for consistent enforcement. It also picks up on ESMA's points raised in its recent letter on whether or not the delegation rules should be complemented by: (i) imposing quantitative criteria; (ii) providing a list of core or critical functions that have to be performed by the AIFM; or (iii) any other requirements. Also (without specific mention of Brexit and an expected uptick in delegation of portfolio management to non-EU entities) if the rules should apply regardless of a delegate's location, in order to avoid 'regulatory arbitrage' when structuring.

These proposals potentially have a wide impact on fund structuring, and there is likely to be industry pushback, in particular as the current models are standard industry practice. Fund managers will also be keen to ensure they can preserve delegation arrangements set up as part of their Brexit planning.

### **Revisiting valuation rules**

In light of recent valuation issues due to COVID-19, the Commission asks various questions around the AIFMD valuation rules. ESMA proposed in its August letter that AIFMD is amended so that an external valuer is only liable to the AIFM for any losses suffered because of the external valuer's gross negligence. This would be a welcome amendment, as in some jurisdictions the current simple negligence provision acts as a disincentive for external valuers and is not always an insurable risk.

### **Capturing and monitoring risks to the financial system across sectors and borders**

The Commission invites views on whether or not the macroprudential framework should be enhanced, to improve supervisory reporting requirements and harmonise liquidity risk management tools for AIFMs and supervisors. This includes defining an inherently liquid/illiquid asset and whether rule amendments are needed to enable National Competent Authorities (NCAs) to require the suspension of units. This is a field of broad regulatory scrutiny, given recent stressed market conditions, in particular the new rules applying to Non-UCITS Retail Schemes (NURS) (UK authorised open-ended funds available to the retail market that can invest substantially in illiquid assets) that came into force on 30 September 2020.

There are extensive questions on how to improve capturing risks to financial stability. These include both broadening access to data by supervisory authorities and to add new data fields to the AIFMD reporting templates (such as additional details for calculating leverage, on the liquidity profile of a fund's portfolio, on non-EU master AIFs that are not marketed into the EU, but with a feeder with the same AIFM that is marketing into the EU, and on sustainability-related data).

### **Integrating AIFMD and the EU sustainable finance legislative package**

Draft delegated legislation seeks to ensure that the rules in the EU's Sustainable Finance Disclosure Regulation are integrated within an AIFM's organisational, operating and risk management

processes. For instance, AIFMs will have to take into account sustainability risks and adverse impacts of investment decisions on sustainability factors in their due diligence policies and processes. In addition, AIFMs must have the necessary resources and expertise for the effective integration of sustainability risks.

A set of questions in the Consultation probes the extent of these rules and whether or not AIFMs should take into account additional sustainability impacts, principles and requirements when making investment decisions.

You can access the 22 October 2020 Consultation document [here](#).

## RELATED PRACTICE AREAS

- Financial Regulation Compliance & Investigations
- Financial Services Corporate & Regulatory Team
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## MEET THE TEAM



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