

ASSET MANAGEMENT AND INVESTMENT FUNDS

Is AIFMD II on the way?

June 2020

The European Commission has published its report on the operation of the Alternative Investment Fund Managers Directive (EU/2011/61) ("AIFMD") and is expected to issue a consultation on proposed amendments to the AIFMD in Q3 2020. Is AIFMD II on the way?

BACKGROUND

Under Article 69 of the AIFMD¹ the European Commission ("Commission") is required to review the scope and application of the AIFMD to establish its impact on investors, AIFs and both EU and non-EU AIFMs, and to determine the extent to which the AIFMD's objectives have been achieved. The Commission is also mandated to propose legislative amendments on foot of this review.

The Commission began its review in 2018 with a general survey² about the functioning of the AIFMD. The [results](#) of that survey were published in January 2019. The Commission noted that most of the AIFMD provisions were assessed as having achieved their objectives, but also identified areas requiring further analysis, including in respect of:

- diverging interpretations of the rules by national regulators, including different approaches about which activities constitute "marketing";
- overlaps in reporting requirements and with other EU disclosure rules;
- the harmonisation of the calculation methodologies for leverage across the AIFMD, the UCITS Directive and other relevant legislation;

- valuation rules; and
- investor disclosure requirements.

Building on the results of the survey, the Commission continued with its review of the AIFMD and on 10 June 2020 published its [report](#) ("Report"), which notes that:

- the AIFMD has improved the monitoring of risks to the financial system and the cross-border raising of capital for investments in alternative assets;
- the AIFMD has played a role in creating an internal market for AIFs and reinforcing the regulatory and supervisory framework for AIFMs in the EU; and
- AIFMs are operating with more transparency for investors and supervisors.

KEY FINDINGS**Impact on AIFs and AIFMS**

EU AIFM Passport. The Report notes the significant growth in both AIFs' total net assets and their cross-border distribution since the introduction of the AIFMD and that the AIFM passport has been a

significant factor in this growth. However, the efficacy of the EU AIFM passport is impaired by national gold-plating, divergences in marketing rules, differing interpretations of the AIFMD by national regulators and its limited scope. The fact that the AIFM passport only allows marketing to professional investors is a factor restricting AIFMs' cross-border activities.³

Cross-border Distribution – NPPRs. The improvement of cross-border distribution of investment products is a key objective of the Capital Markets Union ("CMU"). As part of this CMU work stream disclosure requirements are also being reviewed. The results of this work stream will also impact non-EU AIFMs who currently can only access EU investors on the basis of National Private Placement Regimes ("NPPRs"). Given that the third-country AIFMD passport has not yet been activated, these NPPRs play a key role in market development. However, due to differences between Member States' NPPRs a level playing field does not exist between EU and non-EU AIFMs. Some Member States have closed market access for third country entities entirely. Some Member States have suggested further harmonising the NPPRs, whereas

¹ Article 69 contains a list of matters to be included in the review.

² This survey was carried out by KPMG on behalf of the Commission.

³ The Report notes that AIF distribution is subject to MiFID II rules so any change to the definitions of investors under the AIFMD would need to take account of the interaction of the AIFMD with the relevant MiFID II provisions. In the recently published review of CMU, the High Level Forum recommended a targeted review of MiFID II which includes a proposal to amend MiFID II by end 2020 to introduce a new definition of **qualified investor** whose informational needs and protection requirements are not the same as for the other "retail" investors.

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other Member States consider that activating the AIFMD passport for third country entities, followed by a phasing-out of NPPRs, would be a better solution to this issue. Therefore, the activation of the third-country passport and subsequent phasing-out of the NPPRs is likely to form part of any proposals to amend the AIFMD.

Impact on Investors

Depositary – Potential Passport. The depositary regime is functioning well, although targeted clarifications may be required where AIFMs use tri-party collateral management models or when central securities depositories act as custodians. However, the Report notes that the lack of a depositary passport is not in keeping with the spirit of the single market. Further, the limited choice of service providers in smaller markets means that concerns relating to concentration risk exist where a single depositary could hold the assets of all AIFs established in a Member State.

Valuation Rules. These rules are required to establish each investor's share in an AIF and to monitor the AIF's performance. The Report found that the AIFMD brought "some discipline and structure to the AIF valuation process". However, there may be issues with the binary nature of the valuation rules as a combined use of internal and external valuers is excluded, as well as uncertainty around the liability of external valuers which is determined under the national laws.

Disclosures. The disclosure rules in the AIFMD have increased transparency,

although the Report notes that some professional investors request information other than that prescribed by the AIFMD.

Impact on Monitoring and Assessment of Systemic Risk

The Commission found no evidence to suggest that the thresholds of assets under management above which the activities of AIFMs may pose significant systemic risk should be adjusted.

Supervisory reporting requirements allow regulators to monitor risks to the financial system. It is suggested that the current reporting template could be adjusted, particularly where it overlaps with other reporting requirements.

The Report notes a trend of expanding **non-bank lending**. Granular information on certain asset classes, such as leveraged loans and collateralised loan obligations, as well as the information on indirect linkages between banks and non-banks is currently missing, but is relevant for macro-prudential oversight.

Some adjustments around **leverage** may be called for following the conclusion of the FSB and IOSCO's work in this area, which is focused on data reporting and the ESRB's recommendations to address liquidity and leverage risks in investment funds.⁴

A shift from variable towards fixed **remuneration** appears to have introduced greater risk-aversion in the AIFM sector and increased overall awareness of good remuneration systems.

Impact on Investment in Private Companies

The Report notes that private equity fund managers encounter significant barriers to marketing their funds in other Member States. Therefore, the AIFMD could be amended to better accommodate the private equity sector by removing unnecessary charges and seeking more effective ways to protect non-listed companies or issuers.

NEXT STEPS

The Report has been submitted to the European Council and Parliament as required under the AIFMD. As mentioned above, the Commission may make proposals, including legislative amendments to the AIFMD, on foot of its review. The Commission is expected to issue a consultation on the AIFMD in Q3 2020 and any subsequent legislative proposals are likely to follow in mid-2021. Based on the findings in the Report the consultation and any subsequent legislative proposals are likely to be focused on:

- Marketing and Distribution including, NPPRs;
- Leverage and liquidity;
- Depositary passport;
- Reporting; and
- Supervisory convergence.

If you have any questions on, or would like to discuss the foregoing in more detail, please do not hesitate to contact a member of our team.

⁴ The recent consultation on leverage in AIFs is part of ESMA's response to these recommendations. That consultation closes on 1 September 2020.

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