BRIEFING
EU Legislation in Progress

European Parliament

Amendments to AIFMD and UCITSD

Managing risks and protecting investors

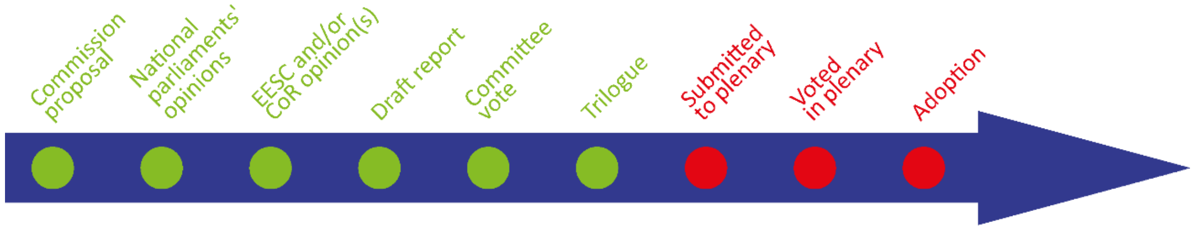
OVERVIEW

Two European Union (EU) directives regulate the EU collective investment funds industry: the Directive relating to undertakings for collective investment in transferable securities (UCITS) and the Alternative Investment Funds Manager Directive (AIFMD). The UCITS Directive, which covers mutual funds, lays down uniform rules, allowing them to be offered cross-border, while the AIFMD, which covers hedge funds and private equity, lays down the rules for authorising, supervising and overseeing the managers of such funds. While reviewing the application of the scope of the AIFMD (as mandated), the European Commission considered that a number of issues highlighted in the AIFMD review were equally relevant for the activities of UCITS. As a result, it proposed to amend both directives, to better align their requirements.

The Council agreed on its general approach in June 2022. Within the European Parliament, the file was assigned to the Committee on Economic and Monetary Affairs (ECON). It adopted its report in February 2023, and Parliament confirmed the committee's decision to enter into interinstitutional negotiations in plenary the same month. The co-legislators reached a provisional agreement in July 2023, which now needs to be formally adopted by the two institutions.

Proposal for a Directive of the European Parliament and of the Council amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services and loan origination by alternative investment funds

Committee responsible:	Economic and Monetary Affairs (ECON)	COM(2021) 721 25.11.2021
Rapporteur:	Isabel Benjumea (EPP, Spain)	2021/0376(COD)
Shadow rapporteurs:	Paul Tang (S&D, the Netherlands) Billy Kelleher (Renew, Ireland) Mikuláš Peksa (Greens/EFA, Czechia) Eugen Jurzyca (ECR, Slovakia) Gunnar Beck (ID, Germany) José Gusmão (The Left, Portugal)	Ordinary legislative procedure (COD) (Parliament and Council on equal footing – formerly 'co-decision')
Next steps expected:	Final first-reading vote in plenary	



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Introduction

Capital markets legislation in the EU is composed of a set of legislative texts. Two main areas of legislation relate to: (i) investment services and activities; and (ii) investment funds. The principal texts regulating investment services and activities are the Directive on Markets in Financial Instruments (also known as **MiFID II**) and Regulation on Markets in Financial Instruments (also known as **MiFIR**). In addition, the Directive on undertakings for collective investment in transferable securities (**UCITS Directive**) and Directive on Alternative Investment Fund Managers (**AIFM**) regulate investment funds. These main legislative texts are complemented by several others, including the Prospectus Regulation, the Market Abuse Regulation and the European Market Infrastructure Regulation. In 2021, the European Commission reviewed the functioning of several of these legislative acts and proposed various amendments. The amendments to the UCITS Directive and AIFMD are the subject of the present briefing.[1]

Existing situation

Collective investment funds are investment products created with the sole purpose of gathering investors' capital, and investing that capital collectively through a portfolio of financial instruments such as stocks, bonds and other securities. With regard to the regulation of collective investment funds in the EU, the two main legislative texts are the UCITS Directive and the AIFM Directive. At the risk of oversimplifying, the UCITS category comprises mutual funds, while the second regulates other types of investment funds, such as hedge funds and private equity. The industry has significantly increased in size during the past decade. Between 2010 and 2020, the net assets of UCITS and AIFs domiciled in Europe increased from a total of €8.6 trillion to €18.8 trillion.

Mutual funds and UCITS

The basis for European investment law is Council Directive 85/611/EEC of 1985, known as UCITS I. Focusing on product regulation, UCITS I established Europe-wide minimum standards for the authorisation and operation of UCITS with the purpose of achieving: (i) regulatory harmonisation; and (ii) adequate (retail) investor protection.

Many Member States went ahead and imposed stricter requirements than required under UCITS I. This lack of harmonisation functioned as a barrier to the cross-border sale of funds. New proposals were released in the 1990s to correct and harmonise the 1985 Directive with European regulations. Although they led to a draft UCITS II Directive, the debate was discontinued, as the goals were excessively ambitious at a moment when the Council of Ministers could not reach a common viewpoint.

Instead, two directives were adopted in 2001. Directive 2001/107/EC – also known as the UCITS III **Management** Directive – raised the requirements for UCITS management companies, by demanding a greater level of sophistication to handle more complicated financial instruments. Directive 2001/108/EC – also known as the UCITS III **Product** Directive– granted more investment flexibility to UCITS management companies in response to changing financial market conditions. The directive changed the criteria, which led to more investments being eligible.[2] For the first time under EU law, financial derivatives could be used for UCITS investments. The directive also raised the limit that UCITS may invest in single issuers.

A few years later, with the objective of investor protection in mind, another UCITS Directive was adopted. This directive (2007/16/EC – also referred to as UCITS EAD), sought to restrict techniques (typically using derivatives) that had been developed by some UCITS management companies to circumvent liquidity criteria.

Directive 2009/65/EC (known as the consolidated UCITS Directive), consolidated the rules that already existed in previous UCITS directives and other EU laws. It also introduced some features aimed to contribute to the growth of the UCITS market, including rules for master-feeder structures[3] and fund mergers. A 2-3 page form with investor information, known as the KIID, or key investor information document, was also introduced.

Lastly, following the global financial crisis, a fifth UCITS Directive was adopted in 2014 (Directive 2014/91/EU). The aim of this directive was to improve investors' confidence in UCITS through strengthening requirements on depositary functions, remuneration policies and sanctions for serious breaches. To do so, the directive introduced specific provisions on the depository's safekeeping and oversight duties, and defining the conditions in which safekeeping duties can be delegated to a sub-custodian. In addition, it introduced a requirement for the UCITS management company to implement a remuneration policy that is consistent with sound risk management and complies with minimum principles. Lastly, it laid down the administrative sanctions and measures that the NCAs should be empowered to apply.

AIFMs and the AIFMD

The AIFMD was one of several regulatory proposals put forward by the EU to tackle the weaknesses and risks brought to the fore by the 2008-2009 global financial crisis (GFC).[4] Indeed, at EU level, there was no appropriate regulation of 'alternative investment funds'' activities, despite a few provisions applicable to hedge funds and private equity funds. Moreover, the EU regulatory landscape was fragmentary because of the systematic delegation to the laws of Member States. Given the international nature of alternative management, this situation could create significant risks and exposed an important regulatory gap. The crisis did not therefore create the need for, but rather provided impetus to the development of this new regulatory framework.

In addition to consultations within the EU, the push for financial regulation took place at global level, through the various G20 and Financial Stability Forum (now Financial Stability Board) recommendations, as well as the high-level principles on the regulation of hedge funds published by the International Organisation of Securities Commissions (IOSCO).

The Alternative Investment Funds Manager Directive (AIFMD) was adopted in 2011[5] and established a regulatory framework covering the activities of the Alternative Investment Funds (AIF) sector. While the AIFMD adapted many instruments from the UCITS Directive with respect to the regulation of fund managers, significant differences in the regulatory approach still exist between the two directives. To mention two fundamental ones: except for very focused provisions on investments in securitisations, the AIFMD regulates alternative fund **managers** and not the funds themselves.[6] The reason put forward by the Commission was that 'financial stability and investor risks stem primarily from the conduct and organisation of the manager and the providers of key services, notably the depositary and valuation agents'. Another is that the UCITS Regulation was conceived for funds marketed in the retail market, whereas the AIFMD framework is principally focused on the regulation of AIFM managing AIFs for professional investors. The second fundamental difference between the two directives is that the AIFMD contains a comprehensive framework for activities by AIFM and AIF domiciled outside the EU, whereas the UCITS does not contain a comprehensive third-country regime.

The directives in (more) detail

The UCITS Directive(s)[7]

Chapter I (Articles 1-4) contains provisions relative to the subject matter, the scope and the definitions used in the directive.

Chapter II is composed of a single Article, which relates to the authorisation of UCITS.

Chapter III (Articles 6-26b) sets obligations regarding management companies. Specifically, Articles 6-8 concern the conditions for taking up business. Article 9 deals with relations with third countries. Articles 10-15 relate to operating conditions, and Articles 16-21 concern the freedom of establishment and the freedom to provide services.

Chapter IV (Articles 22-26b) sets obligations regarding the depositary.

Chapter V (Articles 27-31) contains obligations regarding investment companies. Articles 27-29 contain the conditions for taking up business, while Articles 30-31 contain provisions on operating conditions.

Chapter VI (Articles 37-48) relates to mergers of UCITS. Articles 37-40 set the principle and deal with the authorisation and approval. Articles 41-45 contain provisions relative to third-party control, communication with unit holders and other rights of unit holders. Articles 46-48 contain provisions relative to costs and entry into effect.

Chapter VII (Articles 49-57) establishes obligations concerning the investment policies of UCITS.

Chapter VIII (Articles 58-67) regards master-feeder structures. The articles in the chapter deal with the scope and approval (Articles 58-59), the relationship between the feeder and master UCITS (Article 60),[8] depositaries and auditors (Articles 61-62) as well as compulsory information and marketing communications by the feeder UCITS to investors and the NCA (Article 63). In addition, they establish the relevant disclosures and procedures for the conversion of existing UCITS into feeder UCITS and change of master UCITS (Article 64), the obligation for the feeder to monitor the activity of the master UCITS (Articles 65-67), as well as additional obligations for the master UCITS (e.g. provide information to the NCAs).

Chapter IX (Articles 68-82) establishes obligations concerning information to be provided to investors. Articles 68-75 concern the publication of a prospectus and periodic reports. Article 76 has to do with the publication of other information, namely on the issue, sale, repurchase or redemption price of its units, at least twice a month. Lastly, Articles 78-82 concern key investor information.[9]

Chapter X (Articles 83-90) sets general obligations of UCITS.

Chapter XI (Articles 91-96) contains special provisions applicable to UCITS which market their units in Member States other than those in which they are established (UCITS passport).

Chapter XII (Articles 97-110) contains provisions concerning the authorities responsible for authorisation and supervision.

The last chapter (Chapter XIII – Articles 111–112a) empowers the Commission to adopt technical amendments to the directive in specific areas, provides that the Commission will be assisted by the European Securities Committee, and empowers the Commission to adopt delegated acts.

The AIFMD

The first chapter of the directive contains general provisions, i.e. subject matter (Article 1), scope (Article 2) and exemptions (Article 3), definitions (Article 4) and the determination of the AIFM (Article 5).

Chapter II of the directive (Articles 6-11) deals with the authorisation of the AIFM.

Chapter III of the AIFMD sets the operating conditions for AIFMs. Specifically, Articles 12-17 contain general requirements, Articles 18-19 organisational requirements, Article 20 deals with the delegation of AIFM functions and Article 21 deals with the depositary.

Chapter IV contains transparency requirements.

Chapter V (Articles 25-30) contains provisions relative to AIFMs managing specific types of AIFs. Article 25 is dedicated to AIFMs managing leveraged AIFs, while Articles 26-30 set obligations for AIFMs who manage AIFs which acquire control of non-listed companies and issuers (mainly private equity funds).

Chapter VI (Articles 30a-33) sets the rights of EU AIFMs to market and manage EU AIFs in the European Union.

Chapter VII (Articles 34-42) contains specific rules in relation to third countries.

The penultimate chapter (Chapter VIII – Articles 43 and 43a) contains provisions relative to marketing to retail investors.

Lastly, Chapter IX (Articles 44-55) relates to the competent authorities. Articles 44-49 contain provisions for the designation, powers and responsibilities of competent authorities, as well as the power and competences of ESMA. Articles 50-55 concern cooperation between different competent authorities.

Preparation of the proposal

Article 69 of the AIFMD mandated the Commission to start assessing the scope and functioning of this legal framework by July 2016, and to present a report to the European Parliament and Council. Drawing on the preparatory work, the Commission submitted a report to the co-legislators in June 2020, assessing the application and the scope of the AIFMD.

The AIFMD report, as well as stakeholder feedback, noted that, while the AIFMD has established an effective supervisory regime for AIFMs, ensured high levels of investor protection and facilitated the creation of the EU AIF market, specific areas exist where the framework could be improved. Three main areas were identified: (i) difficulties in monitoring and managing financial stability risks. These may stem from gaps in the market data submitted to NCAs, or market developments and innovation since the entry into force of the directive; (ii) inefficiencies in managing investment funds. These come from an uneven playing field for loan-originating fund managers, uneven supervisory reporting requirements and market depositary concentration in smaller markets; and (iii) insufficient clarity of the applicable legal requirements, stemming from divergent interpretations of the legal requirements for fund managers delegating their functions to third parties or different national supervisory practices.

The Commission's impact assessment considered various policy options to achieve three improvements in the AIFMD. To implement operational requirements for the managers of loan originating AIFs, to ensure that risks to financial stability are mitigated and investors are protected whilst levelling the playing field for those funds in the internal market, the Commission decided to harmonise requirements for AIFMs managing loan-originating AIFs.[10] To increase competition for depositary services provided to AIFs in those markets where there are a limited number of depositary service providers, the impact assessment proposed to maintain the general rule requiring the depositary to be based in the same Member State as the EU AIF, but to allow NCAs in smaller markets the possibility to permit AIFMs to source such services from the depositaries established in other Member States. Lastly, to improve the effectiveness of the AIFMD and UCITS rules on delegation, to ensure the necessary level of investor protection across the Union, the Commission chose to specify further AIFMD and UCITS rules on delegation.

The changes the proposal would bring

UCITS

Article 2 (definitions) adds the definition of 'central securities depository', cross-referencing to the relevant Regulation.

Article 7(1)(b) focuses on the people managing the company and adds to the existing article that they must number at least two, either employed directly by the UCITS, or employed through another company but committed to the UCITS on a full-time basis and residing in the EU. Point (c) focuses on the programme of activity that must accompany an application for authorisation and adds elements that it must specify regarding the technical and human resources conducting the management of the company.

Article 13 (introductory phrase) is amended to clarify the functions which management companies can delegate to third parties. Those are the ancillary services set out in Article 6(3) and the functions described in Annex II. Point (j) further obliges the managers to justify the entire delegation structure objectively. Lastly, a new point 3 obliges NCAs to notify ESMA of any delegations made by management companies to third-country entities on an annual basis. The point further specifies what must be included in the delegation notifications and empowers ESMA to draft regulatory technical standards (RTS) to determine the content of the notifications and the relevant forms, templates and procedures. ESMA, in turn, must report to the Commission, Parliament and Council on these practices. Lastly, the article would empower the Commission to adopt a delegated act, to further specify the conditions for delegation and the conditions under which the management company of UCITS is to be deemed a 'letter-box' entity.

A new article 18a is proposed. According to the article, Member States would have to ensure that at least the liquidity management tools set out in Annex IIA are available to UCITS. Moreover, after assessing their suitability, management companies would select at least one liquidity management tool (LMT) from the list and include it in the fund rules or instruments of incorporation. ESMA would be empowered to develop draft RTS to provide definitions and specify the characteristics of the LMTs.

Two new articles are proposed after Article 20. New Article 20a would introduce an obligation on management companies to report periodically to the NCAs on the markets and instruments in which they trade on behalf of the UCITS. ESMA would develop draft RTS specifying the details to be reported, as well as draft implementing technical standards (ITS), specifying the format of the reports and the reporting frequency. According to Article 20b, ESMA, in cooperation with other ESAs and the European Central Bank, would be tasked with producing a report for the development of integrated supervisory data collection.

Article 22a(2) would be amended to except depositaries from the requirement to perform ex-ante due diligence where the custodian is a central securities depositary (CSD) – because those that have been authorised are sufficiently vetted. In the same vein, in Article 22a(4), the provision of services by a CSD acting in the capacity of issuer CSD[11] would not be considered a delegation of the depositary's custody functions.

Relative to the possibility of a UCITS repurchasing or redeeming its units at the request of any unit-holder, Article 84(2b) (derogations) would empower the home Member State NCAs to require UCITS management companies to activate or deactivate a relevant LMT. The situations in which the NCA may exercise those powers would be the object of RTS drafted by ESMA (point 3f). In addition, point 3 (obligation to notify the relevant NCAs) would be significantly broadened (3a-3e) to establish a notification and cooperation procedure among NCAs, ESMA and the ESRB prior to requiring activation or deactivation of a LMT.

Two points (3) and (4) would be added to Article 98 on powers of NCAs, to strengthen supervisory cooperation. The UCITS host Member State NCA may accordingly request the competent authority of the UCITS home Member State to exercise its supervisory powers, specifying reasons for its request and notifying ESMA and (if risks to financial stability) the ESRB. In cases that may have cross-border implications or investor protection issues, ESMA could request an NCA submit explanations.

Lastly, a new Article 101a would require ESMA to conduct, on a regular basis, a peer review of supervisory practices in applying rules on delegation with a particular focus on preventing the creation of letter-box entities. Complementing this, new article 110a would require the Commission to review the delegation regime and its implementing measures, and propose the necessary amendments to preclude the formation of letter-box entities.

AIFMD

Article 4 (definitions) is complemented with the definition of a 'central securities depository', in line with Regulation (EU) 909/2014.

Article 6(4) (conditions for taking up activities as AIFM) would extend the list of ancillary services that AIFMs can provide, in addition to collective investment management. It would include activities permitted by other Union laws, like administration of benchmarks or credit servicing.

Article 6(6) is amended to update the references to the rules laid down in MiFID II (Directive 2014/65/EU), which applies to AIFMs providing ancillary services.

Article 7(2) (application for authorisation) is amended in part to expand the information regarding the AIFMs. The additional required information is a detailed description of the human and technical resources supporting the AIFMs' activities. Article 7(5) deals with delegation arrangements. It sets out that when an AIFM delegates more functions of portfolio/risk management to third-country entities, it must notify ESMA about particular information, which includes the AIFM, the delegate, the delegated functions, the retained functions, as well as any other information to analyse delegation arrangements. Two further points are added to the article. The first empowers ESMA to adopt draft RTS to determine the content of delegation notifications. The second is an obligation for ESMA to present to the Parliament and Council reports analysing market practices with regard to delegation every two years.

Article 8(1)(c) (conditions for granting authorisation) is expanded to determine that the two persons employed by the AIFM are either employed full-time by the AIFM or are committed full-time to conduct the business of the AIFM and are resident in the EU.

Article 15(3) contains *de minimis* risk management obligations for the AIFM. New Point 3d deals with loan granting activities and sets further obligations (i.e. implement effective policies, procedures and processes for the granting of loans, keep them updated and review them at least once a year. New Point 4a sets out that, in case the borrower is a financial undertaking (Solvency II) or a collective investment undertaking (UCITS), a loan originated by this borrower must not exceed 20 % of the AIF's capital. New Point 4b sets out when this investment limit starts and ceases to apply, whereas new Point 4c sets out that the application date referred to in Point 4b must take account of the particular features and characteristics of the assets to be invested in by the AIF. Lastly, new Point 4e would require AIFMs to ensure that the AIFs they manage retain 5 % of the notional value of the loans they have originated and sold off to the secondary market.

Article 16 on liquidity management is also significantly expanded with the addition of several points. Point 2a would require that AIFs adopt a closed-ended structure if the notional value of their originated loans exceeds 60 % of its net asset value (NAV). Points 2b and 2c would enable AIFMs managing open-ended AIFs to access specific tools for liquidity risk management in exceptional circumstances (point 2f empowers ESMA to draft RTS to specify those tools' characteristics), or even to suspend AIF units repurchases/redemptions. If they do, AIFMs should notify the home Member State's national competent authorities.

Article 20(1) (delegation of AIFM functions) is amended to clarify that delegation arrangements apply to all functions listed in Annex I and to the extended list of ancillary **services** permitted under Article 6(4) (see above). For coherence, **services** (and not only functions) is added to Article 20(1)(f) and paragraphs 3 and 4.

Article 21(11)(c) (depositary) would exempt depositaries from being required to perform ex-ante due diligence when selecting and appointing any third party to which it wants to delegate parts of its tasks, when the custodian is a CSD, as defined in Commission Delegated Regulation (EU) 2017/392. The article would also specify that the provision of services by a CSD in this context would not be considered a delegation of the depositary's custody functions. Point (16) of the same article would be amended to add the obligation for depositaries to make available information not only to their competent authorities but also to the competent authorities of the AIF that has appointed it as a depositary and to the competent authorities of the AIFM that manages the AIF.

Article 23 (disclosure to investors) is supplemented in paragraphs (1) and (4) to improve the transparency of AIFM activities for investors. In Article 23 (1)(h) the description of the AIF's liquidity risk management would have to include disclosing the possibility and conditions for using liquidity management tools from the aforementioned Article 16. Moreover, new paragraph (1)(ia) would oblige the AIFMs to provide to investors a list of fees and charges connected to the operation of the AIF and borne by the AIFM or its affiliates. As for the elements periodically disclosed to investors (point (4)), they should include the portfolio composition of originated loans, but also – on a quarterly basis – the fees and charges charged or allocated to the AIF or its affiliates, as well as any parent company, subsidiary, or special purpose entity established by the AIFM, the staff of the AIFM or its affiliates, in relation to the AIF's investments.

In Article 24(1) (reporting obligations to competent authorities), the words 'principal' (relative to the markets) and 'main' (relative to instruments) are deleted, to expand the reporting obligations of the AIFM. At the same time, point (d) in Article 24(2) relative to the reporting obligation on the main categories of assets in which the AIF invested, would be deleted. In addition, paragraphs 6 and 7 would empower ESMA to develop draft regulatory technical standards and draft implementing technical standards specifying the details to be reported, the format and data of the reports and the reporting frequency and timing.

Articles 35(2) and 36(1) updates the additional conditions to be met by AIFMs with respect to AML/CFT and tax, for marketing with or without a passport of non-EU AIFs managed by an EU AIFM. In the same vein, Article 42(1), which relates to the conditions for the marketing in Member States – without a 'passport' – of AIFs managed by a non-EU AIFM, is updated the same way.

With new article 38a, (peer review of authorisation and supervision of non-EU AIFMs) ESMA would be required to regularly (at least every two years) conduct a peer review of supervisory practices in applying rules on delegation, with a particular focus on preventing the creation of letter-box entities.

Point (j) in paragraph (2) of Article 46 is amended, empowering the competent authorities to require that an AIFM activates or deactivates a relevant liquidity management tool. This power is extended to cover non-EU AIFMs too by adding point (d) in paragraph (4) of Article 47.

Article 47(3) is amended, enabling ESMA to disclose the market data at its disposal in an aggregate or summary form, therefore relaxing the confidentiality standard.

The wording of Article 50(5) (obligation to cooperate) would be amended, obliging the national competent authorities of one Member State to notify ESMA and relevant home and host Member State competent authorities, not when they have reasonable grounds, but rather ***clear and demonstrable*** grounds to suspect that acts contrary to the AIFMD are being or have been carried out by an AIFM not subject to supervision by those competent authorities. In addition, several paragraphs (5a to 5g) are added to the article to strengthen supervisory cooperation. Accordingly, competent authorities notify other relevant authorities, ESMA and ESRB, prior to requiring activation or deactivation of a liquidity management tool (Articles 46(2) and 47(4). In addition, the competent authority of a host Member State of the AIFM may request the competent authority of the home Member State of the AIFM to exercise its supervisory powers specifying reasons for its request and notifying ESMA and the ESRB, if there are risks to financial stability. ESMA is empowered to issue an opinion to the NCAs of the home Member State of the AIFM, relative to activation/deactivation of the liquidity management tool. In case the NCAs do not comply, they must inform ESMA, which may publish the fact and the reasons provided by the NCA for refusing. Lastly, the last paragraph (7) in Article 50 would empower ESMA to develop regulatory technical standards indicating when the competent authorities' intervention would be warranted.

It is proposed to amend paragraph (5) of Article 61 (transitional provisions), permitting the competent authorities to allow depositary services to be procured in other Member States until the measures are taken following a review of the need to introduce a depositary passport.

Lastly, new article 69b (review) would mandate the Commission to initiate a review of the delegation regime laid down in Directive 2011/61/EU and its implementing measures, with a view to proposing the amendments necessary to preclude the formation of letter-box entities (see above, Article 38a). It also mandates ESMA to issue a report aimed at streamlining supervisory reporting requirements for AIFMs and to take it as a basis for developing draft regulatory technical standards for supervisory reporting under Article 24 of AIFMD.

Advisory committees

Neither of the two advisory Committees has adopted an opinion on the file.

National parliaments

The deadline for the submission of reasoned opinions on the grounds of subsidiarity was 29 March 2022. No subsidiarity concerns were raised.

Stakeholder views[12]

The European Fund and Asset Management Association (EFAMA) welcomed the European Commission's review of the AIFMD. The Association is of the view that setting out targeted improvements will make strides in advancing the Capital Markets Union, while maintaining the framework that has underpinned a decade of growth in the EU AIF market and proven resilient even throughout recent market stresses. Regarding UCITS, however, the Association questioned the utility of introducing a reporting regime for UCITS funds, given that they are already subject to strict product rules. Similarly, EFAMA remained cautious concerning some of the proposed changes to the delegation and outsourcing requirements and the unintended consequences such changes may have on a tried and tested delegation regime that works to the benefit of investors.

Invest Europe, an association representing the European private equity industry, broadly welcomed the review of the AIFMD, especially its targeted nature, which focuses only on areas related to delegation, loan-origination, and some reporting aspects of the directive.

Legislative process

In Parliament, the file was assigned to the Committee on Economic and Monetary Affairs (ECON); rapporteur is Isabel Benjumea Benjumea (EPP, Spain). The rapporteur's draft report was published on 16 May 2022, and the report was adopted in the ECON committee on 2 February 2023. The committee's decision to enter into interinstitutional negotiations was confirmed by plenary on 15 February 2023.

Parliament's position

Parliament's position, as set out in the ECON report, introduces the concept of professional investor as opposed to retail investor. A professional investor is defined as an investor considered to be a 'professional client or may, on request, be treated as a professional client within the meaning of Annex II to MiFID'.[13] Managers would also have to provide additional information regarding the legal name and relevant legal identifier of the AIFM, the AIF and its investment strategy as well as of each delegate, its jurisdiction of establishment and, where relevant, its supervisory authority. A brief description of the delegated risk and portfolio management functions, including whether each such delegation amounts to a partial or full delegation. The AIFs marketed to retail investors would also have the obligation to ensure that at least one member of its governing body is a non-executive director who is independent in character and judgement and has sufficient expertise and experience to be able to make judgements on whether the AIFM is managing AIFs in the best interest of investors. Where an AIFM intends to manage an AIF on behalf of a third party, and where the third party is to have significant control over the AIF's design, distribution and management, the AIFM should employ heightened scrutiny of the potential for conflicts of interest. AIFMs engaging in such a relationship should submit detailed explanations and evidence to the competent authorities of their home Member State. In particular, they should specify how they prevent systematic conflicts of interest or any other material conflicts of interest arising from the relationship, how any existing or potential conflicts are effectively managed in the best interests of investors and how this is clearly and comprehensively disclosed to investors.

ESMA would also submit a report within 18 months from the entry into force of the amending directive with the following content:

(i) Assessment of the costs charged by AIFMs to investors in UCITS, and the reasons for costs levels and differences between them,
(ii) Proposal of criteria for assessing whether the level of such costs is appropriate, in particular when compared to the level of costs in other jurisdictions worldwide;
(iii) Proposal, if needed, of options for action by competent authorities or by legislators in respect of inappropriate or undue levels of such costs.

Members provide that AIFMs managing loan origination AIFs but also AIFs acquiring loans should have effective policies, procedures and processes for assessing credit risk and administering and monitoring their credit portfolios, except if such loans are shareholder loans that do not exceed in aggregate 150 % of the capital of the AIF.

Council compromise text

The Council published its general approach in June 2022 after agreement in Coreper. Main modifications aim at strengthening the governance of the AIFM and UCITS and conflicts of interest as well as financial management of the AIFM. It also strengthens the liquidity management of loan-originating AIFs.

Provisional agreement

On 20 July 2023, the co-legislators announced that they had reached a provisional agreement. In particular, the deal would enhance the availability of liquidity management tools to fund managers, with new requirements for managers to provide for the activation of these instruments. It would also establish an EU framework for funds that provide credit to companies. Negotiators also agreed on rules for delegation by investment managers to third parties. Finally, the agreement provides for further data sharing and cooperation between authorities and new measures to identify undue costs on funds.

Before it can be adopted, the agreement reached still needs to be confirmed by Parliament – first by the ECON committee then in plenary – and by the Council.

EUROPEAN PARLIAMENT SUPPORTING ANALYSIS

Kramer E., Review of rules for alternative investment funds, EPRS initial appraisal of a Commission impact assessment, European Parliament, April 2022.

OTHER SOURCES

Amendments to the Alternative Investment Fund Managers Directive (AIFMD) and to the Directive relating to undertakings for collective investment in transferable securities (UCITSD), Legislative Observatory (OEIL), European Parliament.

Commentaries by (i) Christian Schmies and (ii) Dirk Zetzsche and Dominik Nast, in Matthias Lehmann and Christoph Kumpan (eds.) *European financial services law: Article-by-article commentary*, Nomos, 2019, pp. 1304-1563.

ENDNOTES

1 For the amendments to MiFID II and MiFIR see this briefing.

2 Including money market instruments, bank deposits, funds of funds, standardised financial futures, or options traded on regulated markets.

3 'Master-feeder structures' are meant to increase the performance of the sector. This is done by (i) reducing the product's selling cost through the large size of the business, and by (ii) pooling of master, as well as feeder fund assets.

4 Nevertheless, the debate on the regulation of non-UCITS funds had already started earlier. See, for example, the 2005 Commission green paper on the enhancement of the EU framework for investment funds.

5 Following its transposition into national legal systems, the AIFMD entered into application on 22 July 2013.

6 Christian Schmies notes in this respect that the AIFMD 'essentially provides for "manager regulation", rather than "product regulation". Qualitative and quantitative investment restrictions as provided for in the UCIS Directive are conspicuously absent in AIFMD'.

7 This is an attempt to summarise the consolidated version of the UCITS Directive. It does not aim to be exhaustive, but instead to provide an overall image of the directive.

8 Zetzsche and Nast note that 'despite being separate legal entities, the master and feeder UCITS are closely intertwined, in that the investment results of the former predetermine the investment results of the latter. (…) Article 60 requires a certain degree of coordination that sets aside the independence of both master and feeder UCITS. (…) This intensified coordination concerns: a) information and disclosure, b) timing and publication of net asset values, meant to avoid arbitrage opportunities, c) suspension of repurchase, redemption or subscription of its units, (…) d) liquidations and e) mergers and divisions.'

9 The KIID is a simplified version of the prospectus (two A4 pages). The document aims to provide investors with appropriate information about the essential characteristics of the UCITS concerned, so that they are reasonably able to understand the nature and the risks of the investment product offered to them.

10 More specifically, the option is to establish common EU rules allowing AIFs to originate loans but requiring AIFMs to develop robust credit assessment procedures, valuation methodologies and specific risk management frameworks to ensure sound credit origination. In addition, to impose concentration limits, limit the funds interconnectedness with the broader financial system and in particular credit institutions, and to impose the closed-ended nature on these funds. Lastly, to require retention of an economic interest when a loan is originated and sold by an AIF on the secondary market.

11 'Issuer CSD' means a CSD which provides either initial recording of securities in a book-entry system ('notary service') or securities accounts at the top tier level ('central maintenance service').

12 This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under 'European Parliament supporting analysis'.

13 MiFID Annex II defines 'professional client' as a client who possesses the 'experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs', and adds criteria such as minimum balance sheet of €20 million. Entities like credit institutions, insurance companies and pension funds are listed among professional clients.

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