



## AIFMD Review Legislation Published: did ESMA get what it asked for?

December 2021

On 25 November 2021, the European Commission published a package of CMU-related legislative measures, including proposed revisions to the AIFMD and UCITS regimes (the **Proposal**) focussing on:

- harmonisation of the UCITS and AIFMD regimes;
- permitted activities of AIFMs and UCITS managers (fund management companies or **FMCs**);
- FMC substance and delegation rules;
- fund liquidity risk management;
- loan-originating AIFs;
- depositaries; and
- FMC supervisory reporting.

As discussed [here](#), the Proposal was preceded by a wide-ranging and detailed set of recommendations for AIFMD and UCITS regime amendments from ESMA. The following analysis highlights the Proposal's key impacts for FMCs and the extent to which it addresses ESMA's August 2020 recommendations.

ESMA RECOMMENDATION	PROPOSED AIFMD / UCITS AMENDMENT	COMMENT
<b>UCITS/AIFMD HARMONISATION</b>		
Harmonise AIFMD and UCITS' reporting and delegation rules.	<p><i>UCITS Delegation</i></p> <p>The Proposal provides for the adoption of UCITS delegated measures which will, in 'large part', apply AIFMD delegation rules to UCITS managers.</p> <p><i>UCITS Reporting</i></p> <p>The Proposal provides for the adoption of UCITS delegated measures specifying the extent and form of periodic supervisory reporting by UCITS managers on markets and instruments in which they trade on behalf of UCITS.</p>	<p>The Proposal provides for the implementation of ESMA's recommendations and notes that the UCITS regime "should ensure for the management companies of UCITS comparable conditions where there is no reason for maintaining regulatory differences for UCITS AIFMs [concerning the] delegation regime, regulatory treatment of custodians, supervisory reporting requirements and the availability and use of LMTs." Notably, the</p>

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	<p><i>AIFM Investor disclosures</i></p> <p>The Proposal expands AIFMD investor disclosure rules providing for additional disclosures on fees borne by the AIFM or its affiliates and periodical reporting on all direct and indirect fees and charges that were directly or indirectly charged or allocated to the AIF or to any of its investments.</p>	<p>Proposal also provides for, potentially onerous, additional AIFMD investor disclosures "to allow an AIF's investors to better track the investment fund's expenses."</p>
<b>FMC ANCILLARY SERVICES</b>		
<p>Clarify scope of FMC permitted activities in addition to collective portfolio management.</p>	<p>The list of AIFMD-permitted ancillary services (Article 6(4)) is extended to include administration of benchmarks or credit servicing.</p>	<p>The extended list of permitted activities is (without explanation) not applied in respect of UCITS managers.</p>
<p>Clarify rules applicable to FMCs performing ancillary services.</p>	<p>AIFMs providing ancillary services involving MiFID financial instruments are subject to MiFID rules and, with regard to other assets which are not financial instruments, AIFMs are subject to AIFMD.</p>	<p>This clarification is included in recital (4) of the Proposal but no legislative amendments supporting the clarification are included nor are there comparable clarifications to the rules applicable to UCITS managers' provision of ancillary services. Both the AIFMD and UCITS Directive already apply specific provisions of the MiFID regime to AIFMs and UCITS managers performing MiFID services in respect of financial instruments and so perhaps the recital clarification can be inferred from existing rules.</p>
<b>DELEGATION &amp; SUBSTANCE</b>		
<p>Clarify rules applicable to FMC delegates providing investment management for an AIF/UCITS and consider whether additional rules for third country delegates are necessary to avoid circumvention of AIFMD/UCITS regulatory standards.</p>	<p>The Proposal requires FMCs to notify ESMA of arrangements under which more risk or portfolio management is delegated outside the EU than is retained by AIFMs or UCITS managers. The content, forms and procedures for ESMA delegation notifications will be set out in delegated measures based on regulatory technical standards to be drafted by ESMA.</p> <p>The delegation information is to allow ESMA make use of already available powers, such as conducting peer reviews of supervisory practices in applying rules on delegation with a particular focus on preventing the creation of letter-box entities as well as to support the Commission's future</p>	<p>The response to ESMA's request is likely to be welcomed by industry as, although amendments to the delegation rules are not off the table, the Proposal postpones consideration of any such measures until adequate data on the extent and impact of third-country delegation is to hand.</p>

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	<p>review of the UCITS and AIFMD delegation regimes.</p> <p>Third-country entities with access to the internal market, including non-EU AIFs and non-EUAIFMs, must not be located in a third country identified as high risk by the EU or that is deemed un-cooperative in tax matters.</p>	
<p>Clarify the maximum extent of delegation permitted and consider quantitative clarification of the letter-box rule (i.e., FMC may be a letter box entity where it delegates performance of portfolio and/or risk management functions to an extent that exceeds by a substantial margin the investment functions performed by the FMC).</p>	<p>The proposal contains substance-related amendments to both the UCITS and AIFMD regimes, including:</p> <ul style="list-style-type: none"> <li>• clarifications that FMCs must have, and evidence on authorisation, appropriate technical and human resources to carry out their functions and to supervise delegates</li> <li>• FMCs must employ at least two persons full-time or engage two persons, who are not employed by the FMC but nevertheless are committed to conduct that FMC's business on a full-time basis and who are resident in the EU</li> <li>• AIFMD delegation rules (principally set out in AIFMD Level 2) are to be applied, in 'large part' to UCITS managers and principally through the future adoption of UCITS delegated measures. However, the proposal amends the UCITS regime to require UCITS managers to justify their entire delegation structure based on objective reasons (as is required under AIFMD Level 1).</li> </ul>	<p>While the inclusion of substance-related amendments was to be expected, it is helpful that the Proposal specifically recognises the benefits of delegation and instead of (further) limiting the extent of delegation permitted under the regimes, opts to provide <i>"necessary clarifications while preserving the benefits of the delegation regimes under the AIFMD and UCITS [Directive]"</i>.</p>
<p>Address legal uncertainties as to the scope of delegation rules, including whether the provision of 'supporting tasks' is subject to delegation rules, and ensure a level-playing field between AIFMD/UCITS and MiFID.</p>	<p>The Proposal clarifies that UCITS and AIFMD delegation rules apply, respectively, to all functions listed in Annex II of the UCITS Directive and Annex I AIFMD as well as to the delegation of ancillary (additional to collective portfolio management) services permitted under Article 6(3) of the UCITS Directive and Article 6(4) AIFMD.</p>	<p>While ESMA's recommendations referenced the AIFMD recital which limits the application of the delegation rules to portfolio and risk management functions and indeed appeared to apprehend the requirements as not applying to other functions listed in Annex 1 (administration, marketing and activities related to fund assets), the Proposal aims to address the legal uncertainties raised by applying FMC delegation rules, not only to all the functions listed in Annex 1 AIFMD/Annex II UCITS but also to any permitted ancillary services e.g. which may</p>

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		be carried out under a FMC MiFID top-up licence.
Clarify rules for secondment arrangements and how these align with substance and delegation rules.	Not addressed in the Proposal.	
Consider measures to address issues related to white-label/third-party service providers.	Not addressed in the Proposal.	
LIQUIDITY RISK MANAGEMENT		
Include ESRB-recommended liquidity risk management tools ( <b>LMTs</b> ).	<p>The Proposal provides for a minimum harmonised set of available LMTs of (i) suspension; (ii) redemption gates; (iii) redemption notice periods; (iv) redemption fees; (v) swing pricing; (vi) anti-dilution levies; (vii) redemptions in kind; and (viii) side pockets.</p> <p>FMCs must:</p> <ul style="list-style-type: none"> <li>• in addition to suspension, choose at least one other LMT;</li> <li>• notify the competent authority on activating or deactivating a LMT;</li> <li>• inform investors of the conditions for the use of LMTs</li> </ul> <p>The Central Bank will have the power to require FMCs (including non-EU AIFMs) to activate or deactivate a relevant LMT in accordance with delegated measures to be adopted based on ESMA regulatory technical standards.</p>	The Proposal is in line with the increased regulatory focus on liquidity risk management and the direction of travel in this space is notable, in particular for FMCs currently reviewing liquidity risk management frameworks in advance of the Central Bank's year-end deadline for such reviews.
LOAN-ORIGINATION		
Consider adoption of a specific framework for loan origination within the AIFMD.	<p>The Proposal contains minimum harmonisation principles for AIFMs active in credit markets, including for the:</p> <ul style="list-style-type: none"> <li>• implementation of effective policies, procedures and processes for the granting of loans;</li> <li>• restriction of lending (not to exceed 20% of AIF's capital) to a single borrower, when this borrower is a financial institution;</li> <li>• prohibition of AIF lending to its AIFM staff, its depositary or its delegate;</li> <li>• retention of an economic interest of 5% of the notional value of the loans they have granted and sold off;</li> </ul>	The Proposal considers that loan-originating funds can provide an alternative source of financing and the minimum harmonisation of national regimes for loan-originating AIFs in line with the general principles, which are aligned with the diversification thresholds applicable to retail-investor ELTIFs, will therefore support the CMU strategy. While largely in line with Central Bank rules for loan-QAIFs, it remains to be seen whether the Proposal will, in final form, impact national rules.

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	<ul style="list-style-type: none"> <li>establishment of AIFs engaged in loan origination to a significant extent as closed-ended structures;</li> <li>legitimisation of lending activity for AIFMs to allow AIFs extend loans across the EU.</li> </ul>	
DEPOSITARY		
Assess the merit of a depositary passport.	<p>The Proposal enables cross-border access to depositary services until the introduction of a depositary passport is feasible following further harmonisation of EU laws.</p> <p>The Proposal provides for the inclusion of CSDs (when providing custody services) in the custody chain but limits the due diligence requirements for European CSDs.</p>	A depositary passport is not, according to the Proposal, currently feasible, however the ability to appoint a depositary other than in the home state of the AIF is intended to improve choice and enable a more competitive service-provider market.
SUPERVISORY REPORTING		
Various updates suggested to the AIFMD reporting regime.	The Proposal acknowledges that granularity of AIFMD reported data could be improved and provides for the simplification and streamlining of the current reporting obligations as part of future-adopted delegated measures replacing the current AIFMD supervisory reporting template.	The Proposal substantially postpones legislative changes to supervisory reporting under the UCITS and AIFMD regimes until after the outcome of an in-depth feasibility study by supervisors to explore potential synergies between existing reporting requirements under different EU laws.

### Next Steps

The Proposal will now proceed through the EU legislative process and once finalised, Member States will have 24 months in which to transpose the adopted amendments to the UCITS and AIFMD regimes.

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