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AIFMD Report – The European Commission Gives Its View on the Success of the AIFMD and Potentially Hints at Future Changes to the AIFMD Regime

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On June 10, 2020, the European Commission (“EC”) published its report into the operations of the Alternative Investment Fund Managers Directive (the “AIFMD”) and associated legislation. The report notes that the AIFMD has largely achieved its policy objectives and has contributed to a dramatic rise in the size of the internal EU funds market. The report does, however, acknowledge that there are areas where the AIFMD could be improved or further harmonisation on areas not covered by the AIFMD might be needed. Of note, particularly in the context of Brexit, are remarks relating to the operation of the national private placement regimes (“NPPRs”) allowing “third country” AIFMs to access investors in the European Union (the “EU”). In addition, the report (re)raises the spectre of enhanced regulation of loan origination funds and CLO vehicles.

I. Background

The EC was mandated pursuant to Article 69 of the AIFMD to assess the impact of the AIFMD on investors, alternative investment funds (“AIFs”), and alternative investment fund managers (“AIFMs”) both within the EU and outside. The report follows on from the publication of an independent report performed by KPMG, which was published in January 2019.

II. AREAS OF NOTE

A. Marketing

The report notes that the EU AIF market “has been on a continuous growth path” since the adoption of the AIFMD in 2011, with “total net assets of AIFs more than doubled in size from € 2.3 trillion to € 5.9 trillion”. The report notes that “the AIFMD passport is confirmed to be an important factor” in such increase.

The report notes, however, that the efficacy of the passport is “impaired by national goldplating divergences in national market rules and varying interpretations of the AIFMD by national supervisors”. Charging additional and ongoing fees (such as in France) and requiring AIFMs to appoint local agents (such as the “solidarity agent” in Spain) when using the AIFMD passport undermines its purpose. We expect AIFMD II will prohibit or restrict such “goldplating measures”. In terms of varying interpretations, we have already seen the European institutions seek to reduce competing definitions of concepts such as “pre-marketing” and “reverse solicitation” in the new “pre-marketing rules” due to come into place next summer as part of the EU’s work on deepening



the Capital Markets Union of the EU (as to which, please see <https://www.paulhastings.com/en-GB/publications-items/details/?id=5698106d-2334-6428-811c-ff00004cbded>).

The report notes that sub-threshold AIFMs encounter significant barriers as a result of not being able to use the marketing passport. Some EU jurisdictions do not permit a sub-threshold AIFM to privately place an AIF in their jurisdiction—this has led to odd situations where a third country AIF of the same size could be privately placed by its third country AIFM in the jurisdiction, whereas a sub-threshold EU AIFM would be prohibited. AIFMD II may resolve the latter point and potentially even permit the use of the passport (perhaps in exchange for slightly increased compliance obligations). From a policy perspective, given that AIFs managed by sub-threshold AIFMs invest largely in SMEs that will require urgent financing and investment following COVID-19, it would seem a sensible move to permit sub-threshold AIFMs' AIFs to more easily raise capital within the EU.

The report acknowledges that marketing AIFs to “retail” and “semi professional” investors remains difficult, as it is not harmonised and remains subject to national rules and notes that the adoption of the new pre-marketing rules means that cross-border distribution could increase. It will be interesting to see whether AIFMD II reduces the burden on AIFMs seeking to market AIFs to “retail” investors. This would seem to be at odds with the general direction of travel, as indicated in the Packaged Retail and Insurance-based Products Regulation (“PRIIPs”) (although any statement that carried interest vehicles should not be considered a PRIIP and therefore not require the production of a Key Information Document would be welcome).

Finally, the report notes that NPPRs that permit third country AIFMs to market into EU member states play an important role in allowing EU investors to access third country funds. The report ominously notes, however, that the use of the NPPRs and the requirement that third country AIFMs using NPPRs only have to comply with a subset of the AIFMD creates an “un-level playing field” between EU and non-EU AIFMs. It is clear that the EC has its eye on Brexit and the ability of United Kingdom-based AIFMs to access investors in the EU following the end of the transition period. This points potentially to adding additional compliance requirements on third country AIFMs that use NPPRs or potentially reintroducing the concept of the “third country passport” (which was kicked into the long grass after Brexit) and which would mean compliance by the third country AIFM with the AIFMD as if it would be based in the EU. The report provides that some EU member states, such as Spain, France, and Italy, do not have NPPRs (or viable NPPRs). It could be that new rules are adopted on an EU-wide level that mean that all countries have to provide viable NPPRs (although the quid pro quo is likely to be increased compliance burden).

It has been speculated that the EC may target the use of “reverse solicitation” on the basis that the European institutions believe that it has been used to the convenience of third country AIFMs to circumvent AIFMD compliance. Indeed, Article 92 of the AIFMD notes that the European Commission is invited to review legislation with respect to EU investors' investing at their own initiative in third country AIFs and the diligence they must undertake before investing. It is possible that AIFMD II might place greater restrictions on the use of reverse solicitation (for instance, the requirement to notify an EU regulator when an investor is admitted as a result of reverse solicitation). This might make it difficult for investors in jurisdictions such as France, Spain and, Italy (jurisdictions without viable NPPRs) to invest in top quality third country AIFs. From a policy perspective, those jurisdictions that do not have viable NPPRs effectively force investors to invest via “reverse solicitation” (whether bona fide or not) and, as such, rather than protecting investors in their jurisdiction, investors end up investing in funds managed by AIFMs who are completely outside the AIFMD regulatory net.



B. Risk Monitoring

The EC sees no need to amend the thresholds at which AIFMs cease to be sub-threshold and are required to be fully compliant with the AIFMD—this is a helpful confirmation.

The report also notes that whilst Annex IV reporting is of considerable utility, it could be “streamlined” given the costs involved (which are usually borne by the investors in the fund). This is a helpful acknowledgment—much of the Annex IV template pertains to hedge funds and is in places duplicative. Indeed, ESMA’s opinion on debt fund regulation (as to which, please see (iii) below) suggests amendments to the Annex IV templates to more accurately capture data from debt funds and their AIFMs.

It is likely that reporting will remain an important feature of the European institutions’ risk management approach. Recently, the Luxembourg regulator (Commission de Surveillance du Secteur Financier) (the “CSSF”) introduced a requirement for Luxembourg AIFMs and non-Luxembourg AIFMs managing regulated Luxembourg AIFs to file a weekly Questionnaire so that CSSF could more timely manage market risk during the COVID-19 crisis.

C. Loan Origination Funds and CLO Vehicles

The report notes “an observable trend of expanding non-bank lending raises financial stability concerns” and that “some granular information on certain asset classes, such as leveraged loans and collateralised loan obligations (CLOs), as well as the information on indirect linkages between banks and non-banks is currently missing but is relevant for macro-prudential oversight. Several stakeholders have asked the Commission to reassess the case for setting common standards for loan-originating AIFs.”

This comment re-raises the spectre of enhanced regulation of loan origination funds and the drawing into the AIFMD net of CLO vehicles that was the focus of ESMA’s opinion on the potential introduction of an EU-wide regime for loan funds that issued in April 2016.

We will discuss this further in a separate PH Stay Current.

D. Remuneration

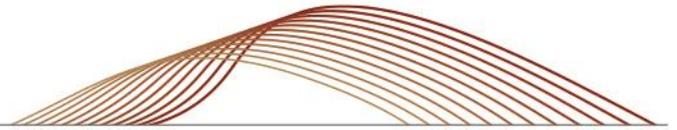
The report notes that some respondents to their consultation advocated aligning the remuneration rules with those from the Capital Requirements Directive, which establishes de minimis institutions and amounts of remuneration that may be exempt from deferring variable payment. This would be a helpful addition to the existing concept of “proportionality” that already exists in the regime.

III. CONCLUSION

The report, whilst broadly praising the AIFMD as a success, acknowledges that there are shortcomings and issues arising in practice, and it is highly likely that the findings will inform the amendments that will make up AIFMD II. Following this report, the EC has to determine whether to put forward proposals for amending the existing related EU legislation (notably, the AIFMD). As the convergence of EU legislation continues, we may also expect to see amendments to the AIFMD that adopt some of the provisions from the Markets in Financial Instruments Directive (2014/65/EU) (“MiFID II”) and Markets in Financial Instruments Regulation (600/2014) in the AIFMD (for instance the 10 per cent “value drop” disclosure rule).

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