Luxembourg Newsflash - 14 November 2023

AIFMD 2 - a fine-tuning of the AIFMD framework and targeted harmonisation with the UCITS framework

The text of the political agreement on the review of the Alternative Investment Fund Managers Directive has been published. The political agreement among the EU policymakers demonstrates their commitment to developing and enhancing the alternative investment fund managers' framework and harmonising it with the UCITS framework.

Reading time: 6 minutes, 26 seconds

Following additional inter-institutional negotiations aimed at fine-tuning the text of the provisional political agreement reached with the EU Parliament earlier in July 2023, the Council of the EU published the final text of that political agreement (**Political Agreement**) on the review of the Alternative Investment Fund Managers Directive (AIFMD 2). Whilst the Political Agreement focuses on the AIFMD, it also touches on the UCITS Directive by aligning requirements between the AIFMD and the UCITS Directive.

More than 10 years after the AIFMD was adopted, the EU co-legislators have now agreed on targeted amendments to the AIFMD and the UCITS Directive so as to reflect industry and regulatory developments in the alternative investment funds and UCITS sectors at European level.

Key elements of the agreement

Authorisation, delegation and reporting

Authorisation. Going forward, alternative investment fund managers (AIFMs) and UCITS management companies (Mancos) must provide more information when applying for authorisation, including with regard to substance. The rules applicable to conducting officers will also become stricter by requiring that these are natural persons domiciled in the EU and either full-time employees or executive member(s) of the governing body with a full-time commitment to conducting that business.

Delegation/Reporting. The Political Agreement emphasises the importance of delegation/sub-delegation arrangements to the extent that AIFMs and Mancos must provide more information on these arrangements to their national competent authority, both at the time they apply for an authorisation and in their regulatory reports to their national competent authority. Going forward, these reports must contain among others (i) information on the delegates and sub-delegates, (ii) quantitative information, such as reporting on the assets of AIFs, respectively UCITS, that are subject to delegation and, (iii) with respect to Mancos, justification of their delegation structure based on objective reasons.

The amended rules aim to provide the supervisory authorities with a clear idea on the substance and operations of the AIFM, respectively the Manco.

Harmonised reporting standards to be defined through level 2 measures. The EU co-legislators tasked ESMA to prepare draft regulatory technical standards (RTS) on the details of the information to be provided, and draft RTS with the appropriate level of standardisation for this information, and the reporting frequency and timing.

While the technical details for the regulatory reporting will still need to be prepared by ESMA, it is to be expected, that Luxembourg AIFMs and Mancos are already complying with quite a substantial part of the newly agreed rules considering that they already are subject to the strict substance requirements and reporting duties set out by CSSF Circular 18/698 on substance.

Loan originating funds

The Political Agreement recognises that the management of AIFs may comprise loan origination activities. In an effort to harmonise the different national regimes on loan originating funds, AIFMD 2, introduces rules relating to AIFs performing loan origination activities. A loan-originating AIF has been defined as an **AIF**: (i) whose investment strategy is mainly to originate loans, or (ii) where the notional value of the AIF's originated loans represents at least 50% of its net asset value.

Once AIFMD 2 has been implemented by EU Member States, new rules will apply to these types of AIFs, such as:

- Loan-originating AIFs must be closed-ended, except where the AIFM can demonstrate that the AIF's liquidity risk management system is compatible with its investment strategy and redemption policy. ESMA will develop draft RTS to determine the requirements with which such an AIF has to comply in order to remain open-ended.
- Loan-originating AIFs have a leverage limit of 300% for closed-ended AIFs and 175% for open-ended AIFs. The leverage percentage is expressed as the ratio between the exposure of the AIF (calculated using the commitment method) and its net asset value.
- A loan concentration limit to a single borrower of 20% of the AIF's capital must be respected if the borrower is a financial undertaking, an AIF or a UCITS.
- AIFMs must ensure that the managed AIF retains 5% of the loans originated and subsequently transferred to third parties (i) until maturity, for originated loans with a maturity of up to eight years or for loans granted to consumers regardless of their maturity, and (ii) for other loans, for at least eight years.
- AIFMD 2 prohibits AIFMs from managing AIFs that originate loans with an "originate-to-distribute-strategy".

Transitional rules have been introduced to make a distinction between (i) existing AIFs originating loans (up to five years from the date of entry into force of AIFMD 2) with a possibility for AIFMs to opt in, and (ii) existing loans (for which the implementation of some rules is not required).

Liquidity management tools

AIFMs and Mancos must implement procedures for activating and deactivating any selected liquidity management tools (LMTs) and the operational and administrative arrangements for using such tools.

AIFMs managing open-ended AIFs and Mancos must select at least two LMTs from a list of LMTs (except side pockets) set out in the relevant Annex. Redemptions in kind and side pockets may also be activated, provided that certain conditions are met. The list contains the usual LMTs and Luxembourg AIFMs and ManCos are already familiar with their use.

The Political Agreement retains the principle that liquidity risk management remains at the discretion of the AIFM, respectively the Manco, subject to specific requirements to notify the competent authorities in its home Member State. Nonetheless, the national competent authority may require the AIFM, respectively the UCITS to activate or deactivate the suspension of redemptions and subscriptions in exceptional circumstances only, in the interest of investors, and after consulting the AIFM, respectively the UCITS.

ESMA is tasked to develop both RTS and guidelines in relation to the LMTs.

Other topics

Ancillary activities. Some non-core services are added to the list of ancillary activities for AIFMs and Mancos, including:

- Reception and transmission of orders in relation to financial instruments for Mancos.
- AIFMs may also provide (i) administration of benchmarks and (ii) credit servicing functions, whereas Mancos may only administer benchmarks, except where these are used in the UCITS that they manage.

Going forward, non-core services, such as investment advice, may also be provided in the absence of discretionary portfolio management activities by the AIFM, respectively the Manco.

Fees and costs. The Political Agreement provides for a disclosure of the fees, charges and expenses borne by the AIFM in connection with the operation of the AIF and ultimately allocated to the AIF. In addition, the AIFM shall, on an annual basis, disclose the charges and expenses directly or indirectly borne by investors.

Additional periodic disclosures for AIFs. Going forward, additional information must be disclosed to investors, such as the composition of the originated loan portfolio and, on an annual basis only, the entities utilised in relation to the AIF's investments by or on behalf of the AIFM.

What's next?

The Political Agreement is now subject to a linguistic review and will then be submitted for adoption by the EU Parliament and the Council of the EU. The EU Parliament is expected to vote on the text in early February 2024. Following that vote, the Council of the EU will formally approve the text voted. Once these formalities are dealt with, the amendments will be published in the Official Journal of the EU and will enter into force on the 20th day after its publication.

We expect the publication and entry into force of AIFMD 2 by the end of Q1 2024. The Political Agreement provides that Member States must apply the measures from two years after the entry into force, with the exception of the measures implementing the reporting requirements, which they must apply from three years after the entry into force of AIFMD 2.

For further information, please get in touch with your usual contact in the Fund Formation Group_

To access the text of the Political Agreement, click here_

To access our newsflash on the AIFMD review, click here_

To access our newsflash on the harmonisation of the EU regulatory framework for debt funds, click here_

Arendt & Medernach SA
Registered with the Luxembourg Bar
RCS Luxembourg B 186371

arendt.com

41A avenue JF Kennedy
L-2082 Luxembourg
T +352 40 78 78 1