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EUROPEAN COMMISSION PUBLISHES ITS REPORT ON THE AIFMD

On 10 June 2020, the European Commission published its long-awaited [report](#) to the European Parliament and Council on the application and scope of the AIFMD (the Report). At 10 pages, the relatively brief Report comments on both the successes of the AIFMD and potential areas in which it could be improved, and concludes by confirming that the Commission is still assessing whether to propose amendments to the AIFMD.

Here are our key takeaways:

Background

- **Requirement for the Report:** Article 69 of the AIFMD requires the European Commission to commence a review on the application and scope of the AIFMD by 22 July 2017. The Report represents the culmination of this review, and follows the earlier publication of an independent report on the operation of the AIFMD, which was outlined in our earlier [briefing](#).

Key takeaways

- **No comment on the third country AIFM passport:** Nine years after the publication of the AIFMD in the Official Journal of the European Union, the provisions through which third country AIFMs would be able to apply for a passport to market their funds into the EU remain inactive. Under Article 67 of the AIFMD, the European Commission has the power to activate these provisions upon receipt of certain positive advice and opinions from ESMA. It has yet to do so, notwithstanding the receipt from ESMA of positive advice and opinions in respect of certain jurisdictions¹. On this point, the Report merely states that the European Commission did not assess the functioning of the AIFMD third country passport as it has not yet been activated.

Managers will need to wait to see whether any amendments that the European Commission proposes to the AIFMD framework include amendments to the third country AIFM passport, or whether instead it would be carried into any proposed AIFMD II framework in its current, dormant state.

- **Recognition of impediments posed through inconsistent national implementation and national private placement regimes (NPPRs):** The Report finds that the efficacy of the EU AIFM passport is impaired by national gold-plating, divergences in national marketing rules and varying interpretations of the AIFMD by national competent authorities. Similarly, it notes that NPPRs vary between member states (and indeed that some member states have closed market access to third country entities entirely).

Of particular interest to UK and other third country managers is the Report's statement that NPPRs require AIFMs to implement only a limited number of AIFMD

¹ See ESMA's advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs dated 30 July 2015 ([ESMA 2015/1236](#)) and [July 2016](#)

requirements, creating an un-level playing field between EU and non-EU AIFMs. This may indicate that the European Commission will explore imposing additional requirements to those that are currently imposed on third country AIFMs that access EU investors using NPPRs. Such AIFMs do not currently need to comply with operating conditions such as the AIFMD's conflicts of interest, risk and liquidity management requirements.

More generally, the findings may indicate that greater convergence will be proposed. This is likely to be welcomed by managers, although will bring with it the risk of 'levelling-up', where jurisdictions with flexible interpretations of the AIFMD are 'levelled-up' to the standard of those with more restrictive interpretations. Managers may be familiar with this issue from the recent amendment to the AIFMD cross-border marketing provisions², which create a harmonised pre-marketing regime that is, in some jurisdictions, somewhat more restrictive than the pre-existing regime. In relation to the issues with inconsistent NPPRs, the Report briefly refers to potential solutions, such as harmonising the NPPRs or activating the third country AIFM passport and phasing out NPPRs, but provides no commentary or conclusion on the relative merits of such proposals.

- **Marketing to retail investors:** The Report notes that the AIFM passport allows marketing only to professional investors, with the result that retail investors may only be approached under the unharmonised regimes of individual member states.

Steps to harmonise marketing of AIFs to retail investors could represent a significant change to the EU asset management industry. Managers will need to wait to see whether the European Commission does propose any steps to address this finding and how far any such steps would go. While the European Commission could explore the harmonisation of marketing to all retail investors, it is possible that it could instead focus on the harmonisation of marketing to a category of 'semi-professional' investors, a concept that certain stakeholders have advocated.

- **Concerns regarding non-bank lending:** The Report states that the expansion of non-bank lending raises financial stability concerns. It notes that stakeholders have asked the European Commission to reassess the case for setting common standards for loan-originating AIFs. Regulatory regimes relating to funds' lending activities currently vary considerably between EU jurisdictions, from those with liberal commercial lending regimes in which lending activities trigger few, if any, additional regulatory considerations, to those in which lending is more closely regulated.

Managers with funds that engage in lending activities will need to watch closely to see whether the European Commission proposes changes in this regard.

- **Private equity-specific commentary:** The Report notes that some argue that the AIFMD could be amended to better accommodate the private equity sector by removing unnecessary charges and looking for more effective ways to protect non-listed companies and issuers. Private equity fund managers will be familiar with the AIFMD's transparency obligations, which require local filings where AIFMs acquire control of private companies, the format of which is not harmonised between jurisdictions. Interestingly, the Report found that these transparency filings were not overly burdensome but noted that it was not possible to establish their value due to the lack of available data.

It is possible that the European Commission will address these findings with tailoring and tweaks for the private equity sector, although the Report does not indicate that a significant relaxation of requirements should be expected.

- **Commentary on depositary-related areas for improvement:** The Report states that the lack of a depositary passport is at odds with the spirit of the single market. It also notes that there is a limited choice of depositaries in certain jurisdictions, which can lead to fears of concentration risk.

² Directive (EU) 2019/1160

As a result, depositaries should wait to see whether the European Commission proposes the development of a depositary passport, either through the AIFMD regime or outside it. The Report also notes that targeted clarifications to the AIFMD may be necessary, such as to address situations where AIFMs use tri-party collateral management or where central securities depositaries act as custodians. Technical amendments to the depositary-related provisions of the AIFMD may be proposed to address these findings.

- **Remuneration:** The Report notes that some stakeholders have called for the alignment of the AIFMD rules on remuneration with the similar regimes provided in other sectorial legislation, such as the requirements of the Capital Requirements Directive (CRD IV).

Such a move may be welcomed by those stakeholders who are keen to see a level playing field in the remuneration requirements that apply in the financial services sector.

- **Additional findings:** The Report contains findings in a number of other areas, including:
 - **Valuations:** The Report notes that there may be issues with the binary nature of the valuation rules, whereby stakeholders understand that a combined use of internal and external valuers is excluded, as well as uncertainty around the liability of external valuers, which varies under national laws.
 - **Reporting requirements:** The Report notes the need to consider streamlining of supervisory reporting requirements, while being mindful of AIFM's sunk costs in complying with the current reporting framework.
 - **Leverage calculation methods:** The Report states that adjustments may be called for by the conclusion of the Financial Stability Board's (FSB) and International Organisation of Securities Commission's (IOSCO) work in this area³, in addition to recommendations of the European Systemic Risk Board (ESRB) for improved measures to assess macro-prudential risks⁴.

Next steps

- **An AIFMD II?** Following submission of the Report, the AIFMD requires the European Commission to propose appropriate amendments to the AIFMD if necessary. The Report states that the European Commission is still assessing the need for further proposals in this domain but acknowledges that certain issues raised in the Report could require further action at an EU level.

It is currently expected that the European Commission will issue a consultation on the AIFMD in Q3 2020. Proposals for legislative amendments, if made, would be expected to follow in mid-2021.

- **The impact of Brexit:** As the UK has left the EU, it will not be obliged to follow any European Commission proposals for amendments to the EU AIFMD regime (subject to any agreement to the contrary with the EU). However any proposals to amend the regimes for third country marketing, whether that be amendments to the system of NPPRs or to the third country passport, will be of great interest to UK and other third country AIFMs.

In addition, the UK is likely to watch the European Commission's proposals closely and to consider whether similar proposals should be made to the UK's AIFMD framework. No firm statement on this point has been made in the UK. [The Chancellor's Financial Services Update of 23 June 2020](#) did not refer to any immediately-proposed amendments to the AIFMD framework.

³ FSB Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities, 12 January 2017; IOSCO Final Report on Recommendations for Liquidity Risk Management for Collective Investment Schemes of February 2018; IOSCO Final Report on Recommendations for Liquidity Risk Management for Collective Investment Schemes of February 2018.

⁴ Recommendation ESRB/2017/7 of the European Systemic Risk Board of 7 December 2017 on liquidity and leverage risks in investment funds.

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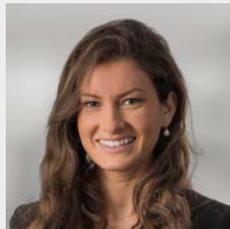
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