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Kirkland Alert

European Commission Publishes Revised AIFMD Rules

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The review of the Alternative Investment Fund Managers Directive (“AIFMD”) has been ongoing for many years. In October 2020, the European Commission launched a [consultation](#) (the “Consultation”) on the AIFMD, on the basis of a [report](#) from the European Commission which was sent to the European Parliament and the European Council that concluded that while the AIFMD provides a high level of protection to investors, a number of areas should be improved.

There has also been recent intervention by the European Securities and Markets Authority (“ESMA”). In a [letter](#) to the European Commission on the AIFMD review, ESMA recommended several priority areas for consideration, including delegation and substance requirements for alternative investment fund managers (“AIFMs”).

On 25 November 2021, the European Commission published the long-awaited draft proposals amending the AIFMD.

Timing

The proposals will now be scrutinized by the European Parliament and European Council. Following review and negotiations, the final text of the amendments will be agreed, formally adopted and thereafter published in the Official Journal of the European Union (“EU”).

As is typical of other European directives, the directive amending the AIFMD will enter into force 20 days following its publication in the Official Journal, and EU member states have 24 months from such date to implement the proposals into national law.

This process will take a minimum of two years, and sponsors can expect application of the proposals in late 2024 or shortly thereafter.

While the proposals are relatively limited in scope, there are significant changes in relation to minimum delegation requirements, loan origination funds, liquidity management tools and disclosure requirements. This *Alert* discusses the key themes of the draft proposals.

Minimum Substance Requirements and Delegation

Minimum Substance

The European Commission's focus on substance of the AIFM entity is emphasized in the draft proposals. As part of the authorization process, AIFMs will now be required to provide more information on the individuals performing the AIFM functions including:

- a detailed description of each individual's role, title and level of seniority;
- a description of such individual's reporting lines and responsibilities within, and outside of, the AIFM entity;
- an overview of the time allocated by the individual to each responsibility;
- a description of the technical and human resources that support the individual's activities;
- information on any delegation and sub-delegation arrangements, setting out a description of the human and technical resources used by the AIFM in monitoring and supervising the delegate.

The proposals require that at least two EU residents are either employed by the AIFM on a full-time basis, or otherwise committed full-time to the AIFM activities.

Delegation

As expected, the European Commission's draft proposals tighten the rules on delegation, in the form of additional reporting and information gathering while ensuring delegation models are preserved.

The draft proposals clarify that although additional requirements apply in relation to delegation of risk or portfolio management, the rules on delegation apply to all of the AIFM functions set out in Annex I of AIFMD, including administration, marketing and activities related to the assets of the fund (including, where relevant, credit servicing, real estate administration, facilities management, advice to undertakings on capital structure or industrial strategy and related matters and services relating to purchases of undertakings and other services connected to their management).

Where an EU-AIFM delegates more portfolio management and/or risk management functions to non-EU entities than it retains, the draft proposals provide that the relevant national regulator must report detailed information on such delegation to ESMA on an annual basis which, in turn, will influence the information that such national regulator will require from an EU AIFM. ESMA is expected to review delegation arrangements and report its findings on the compliance of the delegation arrangements with relevant rules to the European Commission, the European Council and the European Parliament.

Loan Origination Funds

The draft proposals include new rules that apply to AIFMs managing funds that originate loans. For loan granting activities, AIFMs must implement effective policies and processes for (i) the granting of credit, (ii) assessing the credit risk and (iii) administering and monitoring the relevant funds' credit portfolio. This obligation will extend to ensuring that the policies and processes are reviewed at least annually, and are updated.

The European Commission proposes that as an investment restriction for each loan origination fund, the AIFM must ensure that a loan originated to any single borrower does not exceed 20% of the fund's capital where the borrower is an insurance or reinsurance company, a credit institution, a MIFID investment firm, a financial conglomerate, an Undertaking for Collective Investment in Transferable Securities ("UCITS"), a management company or another alternative investment fund ("AIF"). In addition, no loans may be granted to the AIFM, its staff, the depositary or any delegate of the AIFM.

As a risk retention mechanism, the draft proposals require that the AIFM ensures that the fund it manages retains 5% of the notional value of the loans it has originated (and

not purchased on the secondary market) and subsequently sold on the secondary market.

Liquidity Management Tools

Under the draft proposals, an AIFM that manages an open-end fund will be able to choose at least one appropriate liquidity management tool as set out in a new Annex V, which include redemption gates, notice periods, redemption fees and swing pricing. The AIFM is required to implement detailed policies and procedures for the activation and deactivation of the chosen liquidity management tool(s) and the operational and administrative arrangements for the use of such tool(s).

AIFMs that manage open-ended funds may be able to temporarily suspend repurchases or redemptions (or otherwise use any other liquidity management tool as discussed above) where it is in the interests of investors and such tools are included in the fund's constitutional documents. The temporary suspension must only be used in exceptional cases where circumstances require.

In relation to a loan origination fund, the AIFM must require that the fund is closed-ended if the notional value of its originated loans exceeds 60% of such fund's net asset value.

An AIFM would have to notify the relevant national regulator of the activation or deactivation of the liquidity management tool(s).

Increased Disclosures

Under the draft proposals, additional pre-contractual disclosures under Article 23 of the AIFMD will be introduced. These include:

- a description of the AIF's liquidity risk management, including disclosures on the possibility and conditions for using liquidity management tools selected by the AIFM, and the existing redemption arrangements with investors; and
- fees, charges and expenses that are borne by the AIFM or its affiliates in connection with the operation of the fund.

The draft proposals also expand the scope of periodic reporting. On a quarterly basis, AIFMs will be required to report to investors on:

- all direct and indirect fees and charges that were directly or indirectly charged or allocated to the fund or to any of its investments; and
- the detail of any entity that has been established in relation to the fund's investments by the AIFM or its affiliates.

In relation to loan origination funds, the pre-contractual disclosures extend to information on the portfolio composition of the originated loans.

National Private Placement Regimes

There have been no significant changes to the existing third-country marketing regimes. Non-EU AIFMs can continue to market to professional investors in the EU under the relevant National Private Placement Regimes ("NPPRs").

Currently, one of the requirements to market a fund under NPPRs is that non-EU AIFMs and non-EU funds must be established in jurisdictions that are not Financial Action Task Force non-cooperative countries or territories. The draft proposals replace this with a requirement that the AIFM and the fund must not be established in jurisdictions identified as "high risk" countries under the European Anti-Money Laundering Directive (as amended). Additionally, those jurisdictions must not be on the revised EU list of non-cooperative tax jurisdictions, and the jurisdiction in which the non-EU fund or non-EU AIFM is established must have signed an agreement with the Member State in which the shares of the fund are intended to be marketed which complies with the standards set down in the OECD Model Tax Convention on Income and an Capital and which ensures an effective exchange of information in tax matters.

Additional Implementing Rules and Review

The draft proposals also provide for additional regulatory and technical standards to be developed covering a number of areas such as delegation notification process, selection and use of liquidity management tools, and streamlining national regulators' reporting templates.

A further review of the AIFMD is expected to take place within five years after the transposition of these proposals.

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Suggested Reading

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