

AIFMD review



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AIFMD: no major overhaul needed, but more harmonized implementation at EU level

Under the influence of the great financial crisis in 2008 the European co-legislators (European Parliament and European Council) adopted the AIFMD in June 2011.

The sector of alternative investment funds has been and still is extremely heterogeneous across basically all aspects: asset classes (hedge funds, private equity, real estate, Spezialfonds), investor types, investment and redemption strategies, legal, tax and governance structures, custody requirements, valuation and accounting practices as well as transparency. The answer was to regulate the management company and not the fund itself. Some of the above aspects were left to the NCAs, in particular concerning Alternative Investment Funds (AIFs) sold to retail investors.

The driving force behind the European Commission's proposal was the desire to better control the hedge funds with their high willingness to take risks and the sometimes extremely highly leveraged equity funds. But rather than focusing on these two categories alone the Commission decided to address all funds that were not UCITS as AIFs in one directive.

The overall objective was to create a real European internal market for EU and non-EU alternative funds marketed in the EU by introducing a harmonized regulatory and supervisory framework. All AIFs would be subject to the same authorization and registration requirements, proper monitoring of risk and increased accountability of AIFMs holding stakes in non-listed companies.

A survey conducted by KPMG at AIF stakeholders reveals that AIFMD has indeed contributed to creating a European internal market for AIFs. However, some weaknesses remain:

- The AIFMD is not consistently applied across all member states, which can lead to rule arbitrage and an uneven playing field.
 - The reporting requirements by AIFMs to NCAs are being criticised as unnecessarily burdensome and costly. Not all the data asked for are essential, some are duplicative.
 - The information requirements to investors are also excessive, particularly with regard to investments in non-listed companies. Some valuable information like fees, total costs and charges of private equity funds is insufficient. Generally, there is a feeling that different information needs by investor category are not really being respected.
- The remuneration rules contradict some other European legislation raising the question which rules should be followed. In addition, there are also national provisions which complicate matters even further.
- Depository rules are differently interpreted between the member states, for example for the monitoring of cash duties. The one-size-fits-all approach does not accommodate different asset classes and member states.
 - The EU management passport is working well. But the understanding of what "marketing" means differs between the member states. The Commission has addressed this issue in the recently adopted file on "cross-border distribution of funds".



- AIFMD has not yet been put to a critical stress test during a major financial crisis. It does not need a major overhaul, but some parts of the directive should be modified to ensure a level playing field and increase effectiveness and efficiency.
 - The rules for reporting, depositary and marketing should be further harmonized at EU level.
 - Churches, foundations and family offices i.a. should be recognized as “semi-professional investors” seeking investment opportunities with a very high degree of sustainability and relatively low risk level.
- The focus of AIFMD on the management company of AIFs and not the underlying product should not make it impossible to introduce a low risk category (low leverage AIFs) guided by the UCITS limitations of portfolio management thus better allowing for national specificities like Spezialfonds in Germany/ Austria (€ 1,7 bill.) without negatively impacting on the European competitive situation. ●



Gerry Cross

Director of Financial Regulation,
Policy and Risk, Central Bank of Ireland

Key areas to examine under the AIFMD review

A conference on Private Equity and Hedge Funds was hosted by the European Commission in February 2010 which marked the early stages of the consultation process on the Alternative Investment Fund Managers Directive (AIFMD). The Internal Market Commissioner at the time made an instructive remark when he said that the aim was “to extend the scope of regulatory oversight and supervision in order to ensure that all financial activities which are capable of affecting the wider market or real economy are subject to appropriate checks and balances”.

At moments such as this, it is useful to reflect and take stock of the extent of change in the regulatory and legislative landscape since the financial crisis and identify areas for enhancement. While the impact of AIFMD varies across sector and Member State, it has nevertheless been fundamental for the sector as a whole. Following the introduction of AIFMD in 2013, indicative data highlights that net AIF assets have generally increased across national EU markets.

KPMG’s Report on AIFMD (“the Report”) identifies areas which may benefit from review. In some areas, such as the EU marketing passport, there have already been initiatives to address issues identified (through the Cross-Border Distribution of Investment Funds (“CBDF”). Nevertheless, there still may be scope for further amendments, such as the introduction of a de-notification requirement.

In other areas, the Report, makes findings and recommendations. Such

as concluding that the national private placement regimes (NPPRs) which are in place in the majority of Member States surveyed add value to the EU and advocating that these should be retained.

The Report identifies general areas that warrant consideration. This includes finding that while large volumes of data are submitted by AIFMs to NCAs under the AIFMD reporting requirements, not all of this data may be essential and, in some cases could be considered duplicative. As part of the review, there is certainly scope for examining reporting requirements with a view to making focused and targeted changes. Such amendments should include making mandatory inclusion of the legal entity identifier (LEI), adjustments to the categories of AIFs available and inclusion of a method to identify sub-sets of AIFs, such as MMFs.

While finding that the use of high leverage in AIFs is rare, the Report concluded that it would be helpful to harmonize the calculation methodologies for leverage across AIFMD, the UCITS Directive and other relevant legislation. Such a review, which is desirable, should be cognisant of the current work underway at an international level on the topic.

There are also areas absent from the Report which warrant attention as part of any review. For example, ESMA has done significant work in the area of loan origination with the publication of an Opinion addressing matters such as the authorisation of loan-originating funds and their managers, eligible investors, organisational requirements and leverage. Ireland is one of the six Member States to introduce a specific regulatory framework for loan originating investment funds. We see considerable merit in developing a clear and transparent regulatory framework across the EU with respect to loan origination. The AIFMD Review provides this opportunity.

There are also a range of technical amendments, some of which >>>

>>> have been apparent since the introduction of AIFMD, which should also be progressed to improve the functioning, effectiveness and efficiency of the regime. For example, amongst others, this includes reporting requirements related to prime brokers and capital requirements for

internally managed AIFs. There may also be merit in clarifying the responsibilities of the AIFM under AIFMD, particularly in light of the differing approaches taken as part of UCITS. A well-regulated alternative investment management industry plays a significant role in supporting the functioning

of the financial system and wider economy. The review of AIFMD provides an important opportunity for policy makers, regulators and wider industry to ensure the framework is as effective as possible in the delivery of this objective. ●



Joseph Barry

Global Head of Regulatory, Industry and Government Affairs, State Street

AIFMD 2.0: small improvements, big rewards?

The European Union's legislative framework for investment funds is generally highly regarded across the globe, and the Alternative Investment Fund Managers Directive (AIFMD) is an important element of this. This is aptly demonstrated in the recent IOSCO consultation paper on leverage, which

makes numerous references throughout to current provisions of the AIFMD.

The European Commission's report on the operation of the AIFMD, published earlier in the year, presents a broadly positive view with regards to whether the Directive has met its objectives; this is a view that we share. However, with fundamental changes to EU capital markets expected, precipitated by the UK's impending departure from the EU, the focus should be on what can be improved.

Firstly, the depositary requirements set out in the AIFMD have undoubtedly contributed to the establishment of a robust and secure framework. However, it is unclear whether this necessitates that the depositary is established in the home Member State of the AIF. The situation is further complicated when considering non-EU AIFs and the concept of the "Member State of reference". As we consider the next stage of the Capital Markets Union and how to further integrate European capital markets, we believe there is a case to remove such a location requirement. This will also help to ensure that AIFs have access to best-in-class service providers, regardless of their location within the EU.

Secondly, another area that could be revisited, particularly in the context of the UK leaving the EU, is the third-country regime under the AIFMD, including the unintended consequences caused by the interaction with other pieces of EU legislation. For example, under the current EU regulatory framework, the distribution of non-EU ETFs into Europe

has been significantly limited, leading to a reduction in investor choice, even where the non-EU ETFs have higher liquidity and lower cost. On a related point, we believe the approach and the process relating to the granting of equivalence by the European Commission should be revisited, in order to address outstanding conflicts. One example of this is prime brokers in the US, who are subject to a different securities holding framework and are therefore unable to fully satisfy certain AIFMD reporting obligations.

Thirdly, increasing consistency regarding the application of the AIFMD could be helpful in certain areas e.g. reporting standards. While permitting flexibility across Member States can facilitate the recognition of particular market nuances and can enable competent authorities to develop the regime most relevant for their specific market, it should not result in material differences in interpretation, which could result in significant burdens on market participants and create an un-level playing field across the EU.

To conclude, we believe the EU legislative landscape for investment funds is functioning well. Nevertheless, markets are dynamic and constantly evolving, and so the regulatory framework must evolve in turn. We support the EU taking an ambitious approach to improve the AIFMD, although do not believe this requires a fundamental re-writing of the rules. ●

Stéphane Janin

Head of Global Regulatory Development, AXA Investment Managers

How to improve the functioning of the AIFMD?

As recognized today by many securities regulators, the European regulatory framework for funds appears largely adequate. In many cases, it has been taken as a reference in other regions or even at global level through

worldwide regulatory bodies such as the International Organization of Securities Commissions (IOSCO).

Regarding the Alternative Investment Fund Managers Directive (AIFMD), it was initially aimed at tackling both the systemic risk involved in non-UCITS fund management and the lack of cross-border passport for Alternative Investment Funds (AIFs) towards professional investors across Europe.

On these two fronts, AIFMD was largely a success. Regarding systemic risk, the testing in real life of AIFMD provisions demonstrated these provisions were valid. AIF managers had to cope with major market events (the euro crisis, >>>



>>> the UK referendum on Brexit) and regular turmoils, and managed them without significant failure.

Moreover, the final adoption of a Regulation and a Directive on the cross-border distribution of funds on 20 June 2019 complemented the AIFMD provisions for facilitating the practical functioning of the Single Market for funds.

So, what is left and should be improved now?

First, we should collectively be consistent in our European overarching approach. On the one hand, policy-makers and regulators cannot ask for a permanent decrease of the level of management fees for funds – that we obviously agree on – while on the other hand asking at the same time for permanent legislative changes in provisions. European asset managers must remain competitive at global level and cannot suffer from a permanent legislative instability that their non-European competitors do not face.

Second, before proposing regulatory changes, we should wonder if existing rules are already implemented and enforced at local levels. When you look at the first ESMA's Report on "Penalties and measures imposed [by National Competent Authorities] under the UCITS Directive in 2016 and 2017", published on 4 April 2019, you have strong doubts. Over the two years 2016 and 2017, more than 50% of National Competent Authorities (NCAs) in the EEA have never delivered any single penalty or measure on UCITS on their own territory – including some large NCAs. We would be keen to see ESMA publishing a similar first Report on AIFMD in the coming years – as a prerequisite before any decision of amending AIFMD existing provisions.

Third, it leads to the role of the European Commission itself. Under the Lamfalussy regulatory process applicable to financial services since 2001, a "Level 4" has asked the Commission to ensure

the correct enforcement of EU rules by national governments. It reads: "The lack of enforcement by the Commission is seen as having been a serious obstacle to the completion of a single market for financial services". If at last, more than 10 years after its endorsement by European institutions, this Level 4 could become alive, it would be a tremendous progress – to the benefit of European investors and markets.

"European asset managers must remain competitive at global level."

- STÉPHANE JANIN

A decade ago, the AIFMD was an excellent legislative initiative to complement the EU regulatory framework for funds – let's now ensure it is applied. ●



Alexandra Richers

Managing Director, DekaBank

AIFMD review – the best is yet to come

The original objective of the Alternative Investment Funds Managers Directive (AIFMD) is to create an internal market for EU and non-EU AIFs and a harmonised and stringent regulatory and supervisory framework for AIFMs in order to ensure a common level playing field.

What does it mean in practice? The current review has revealed, that most areas

of the provisions are already successfully assessed and the directive has played a major role in helping to create an internal market for AIFs. Thus, an effective legal framework for monitoring and managing the risks associated with the activities of AIFMs is provided. So far so good?

The review made also clear, that there are still difficulties and some aspects that have not (yet) contributed to the achievements of this aim. So there is still potential for optimisation.

Regarding the broad range of AIFs it would make sense to define a subset of AIFs that apply certain limits to leverage and to extend the EU passport for such AIFs to a new category of "semi-professional investors". This would also support the EU's Capital Market Union goals of enhancing cross-border distribution and facilitating capital market investments from new groups of investors.

On top of the European Commission's initiative on cross-border distribution further barriers for both AIF and UCITS marketing across the EU are expected. In terms of the pre-marketing and marketing definition asset managers should be allowed to communicate with potential investors without this being considered already as 'marketing'.

Moreover, investors should have the flexibility to set up a fund with an asset manager in a matter of days. At least, in situations where pre-marketing in the form of negotiation with professional investors has already taken place, fund managers

should be allowed to notify the National Competent Authority (NCA) subsequent to the investors' subscription of fund units.

In terms of marketing communication further efforts to harmonise are needed. The EU marketing passport is suffering from the different approaches taken by NCAs. Specific national requirements create a major burden for asset managers. At minimum, asset managers should be allowed to use marketing material that complies with MiFID II requirements without the need to notify the NCA.

"The EU marketing passport is suffering from the different approaches taken by NCAs."

- ALEXANDRA RICHERS

The AIFMD-Review identifies some areas for improvement that could be addressed by Level 3 measures and may therefore be easily to achieve. While the ESMA should not be seen as generally responsible for addressing deficiencies, it can provide valuable guidance and act as an information hub for all NCAs and market participants. We therefore see a need for further harmonisation of marketing standards for investment funds using EU passports for the cross-border marketing of their units. ●