

Commission Proposal for Review of AIFMD and ELTIF

29 November 2021

As long anticipated, the European Commission has recently published a [proposal](#) to amend the Alternative Investment Fund Managers Directive (AIFMD). The proposal targets specific amendments to the AIFMD and does not entail a wholesale review of the Directive. The Commission also proposes to carry across certain of the amendments to the EU Directive for retail funds, UCITS. At the same time, the Commission published a [proposal](#) for review of the Regulation on European Long-Term Investment Funds (ELTIF).

We summarise below the most significant amendments proposed by the Commission to the AIFMD and ELTIF Regulation, with our views on the potential impact. The proposals at this early stage highlight areas of concern and will be subject to scrutiny and negotiation with the European Council and Parliament, with their final form diverging to an unknown extent from the Commission's proposals.

Key proposed changes are:

- There are no major changes to the power of Alternative Investment Fund Managers (AIFMs) to delegate risk and portfolio management, but the European Securities and Markets Authority's (ESMA) steps to gather further information on delegation arrangements may indirectly lead to further substance requirements.
- Loan origination funds are given their own regime, with a specific restriction on AIFMs establishing open-ended loan origination funds.
- There is a specific new requirement for individual managers for AIFMs, and new requirements on fee disclosure to investors.
- Requirements applicable to ELTIFs exclusively marketed to professionals have been softened.

- Eligible assets that ELTIFs may invest in have been broadened, and ELTIFs may now make co-investments. ELTIFs may now also invest in EU funds managed by EU AIFMs.

Proposed Changes to AIFMD

Topic	Summary	Comment
Loan origination	<p>AIFMs are now expressly permitted to manage loan origination funds (which are referred to as Alternative Investment Funds (AIFs) carrying out “loan granting activities”, in distinction to purchasing loans).</p> <p>Loan origination funds will need to meet the following conditions:</p> <ul style="list-style-type: none"> • Funds must be closed-ended where they engage in loan origination to a significant extent (60% of net asset value). • AIFMs managing funds that grant loans must implement effective related policies, procedures and processes. • Loan origination funds must retain at least 5% of the value of loans that they have originated and subsequently sold on the secondary market. This is to “avert moral hazard and maintain the general credit quality of loans originated by AIFs”. 	<p>The express authorisation for AIFMs to manage loan origination funds addresses current concerns as to the ability of funds to lend in the context of local banking restrictions. This should allow AIFs to grant loans in all EU borrower jurisdictions, although the proposal would have done better to expressly introduce a product “passport”. Also, clarification during the legislative process would be welcomed to allow AIFs expressly to grant loans indirectly as well directly (permitting AIFs to grant loans via one or more subsidiaries), as there are currently different practices in Member States. Finally, the rules only apply to EU AIFMs and AIFs and hence non-EU AIFMs can presumably only continue to conduct loan origination in the EU under local law, in the same manner as now. However, it may be that non-EU AIFs and AIFMs that have applied for marketing under national private placement regimes will obtain the same right.</p> <p>With a few exceptions, the new</p>

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	<ul style="list-style-type: none"> • Lending to a single borrower that is a financial institution is limited to 20% of the fund’s “capital”, to reduce the risk to the financial system. • A fund is prohibited to lend to its AIFM or its staff, its depositary or the AIFM’s delegates. • Funds will need to report to investors on their “originated loan portfolios” (indicated as detailed information on the portfolio composition). 	<p>conditions for loan origination funds either reflect existing best practices or should be manageable in practice. To be watched is the introduction of the new risk retention requirement for funds that originate “with a view to subsequently selling loans”. Usually, funds originating loans would probably not intend to sell these loans; but it is certainly a scenario that one would not want to exclude.</p> <p>The requirement for funds that engage in loan origination to a significant extent to be closed-ended will clearly impact existing open-ended funds, noting there is no present “grand-fathering” relief for existing funds.</p>
<p>Delegation</p>	<p>The proposal requires competent authorities to send to ESMA annual notifications of arrangements where the AIFM delegates more portfolio management or risk management functions than it retains. With the benefit of these reports, ESMA will regularly (at least every two years) conduct a peer review of the supervisory practices of competent authorities in applying the rules on delegation, with a particular focus on preventing the creation of “letter-box” entities.</p>	<p>Delegation arrangements where the delegate performs more functions than the AIFM have long been an area of concern for the Commission. It is interesting to note that, in the accompanying impact assessment, ESMA rejected “fundamental changes” to the delegation rules and specifically rejected options in relation to delegations to third country entities, to require instead competent authorities to inform ESMA about delegation arrangements and to empower ESMA to enforce delegation rules.</p>

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	<p>Further, the Commission will within 5 years after the entry into force of the changes to AIFMD review the delegation regime with particular regard to preventing the creation of letter-box entities.</p> <p>The proposal states that where an “AIFM intends to delegate to third parties” any of the functions listed in Annex I of AIFMD (including ancillary functions such as fund administration or marketing), AIFMD conditions on delegation will apply.</p>	<p>The proposal allows ESMA to influence competent authorities’ approaches to delegation, as competent authorities are required to notify ESMA of “letter-box” delegation arrangements. The content of the related notification form to be developed by ESMA will presumably form the basis for competent authorities to assess the balance between functions retained and those delegated for the purpose of the letter box test.</p> <p>There is some uncertainty about the impact of the application of the proposed new conditions on delegation where an AIFM intends to delegate any Annex I function.</p>
<p>Substance requirements for AIFMs</p>	<p>In relation to “the persons who effectively conduct the business of the AIFM”, there must be at least two individuals who are “sufficiently experienced in the investment strategies pursued by the AIF managed by the AIFM” and who are either employed full-time or who are committed full-time to conduct the business of the AIFM, and who are resident in the EU.</p> <p>There are new provisions for the information that AIFMs applying for authorisation must supply to</p>	<p>The requirement to have two full time employed (or otherwise “committed”) senior managers of each AIFM, each of whom is resident in the EU, should be manageable but may present challenges to some structures. The newly proposed reference to managers “resident in the Union” appears to permit individuals resident in another EU Member State other than the home Member State of the AIFM to act as managers and to be accounted for substance purposes in the AIFM’s home member state. This is a welcome development and</p>

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	competent authorities.	consistent with the EU passport regime.
Treatment of third country AIFMs and funds	Provisions relating to the marketing by non-EU AIFMs of funds, or by EU AIFMs of third country funds, are changed to ensure that any such third country entities are not established in jurisdictions identified as “high risk countries” under the European anti-money laundering directive or are not on the EU list of non-cooperative jurisdictions for tax purposes.	Article 42 (the basis for non-EU managers to market in the EU) already contains the condition that the manager or fund jurisdiction is not listed as a Non-Cooperative Country and Territory by the Financial Action Task Force (FATF), but this is replaced by reference to the two equivalent lists that the EU itself controls. The EU has added a number of offshore jurisdictions to these lists (and in some cases subsequently removed them), and moving from internationally maintained lists to EU controlled lists clearly increases the risk of the EU exerting political influence against non-EU jurisdictions, in particular including countries which the EU has not yet assessed as against the EU list of non-cooperative jurisdictions for tax purposes.
Liquidity management tools	There is specific provision for AIFMs of open-ended AIFs to apply liquidity risk management in exceptional circumstances. All such AIFMs will be required to select at least one liquidity management tools (such as suspension of redemptions) from a new list (Annex V), and have procedures in place to use the tool, and to notify its competent	These provisions provide a framework for open-ended funds to apply liquidity management tools.

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	<p>authority accordingly. ESMA will produce further technical standards to specify the characteristics of the various tools and competent authorities could force their use. The Commission has also flagged a power for ESMA to apply the same requirements on non-EU AIFMs marketing in the EU.</p>	
<p>Investor disclosure</p>	<p>Initial investor disclosure rules are amended to require AIFMs to disclose “a list of fees and charges that will be applied in connection with the operation of the AIF and that will be borne by the AIFM or its affiliates”, with quarterly reporting of “all direct and indirect fees and charges that were directly or indirectly charged or allocated to the AIF or to any of its investments”.</p>	<p>Most funds already report to investors on fees and charges borne by the AIF, although the scope of this reporting may increase. The reference to “indirect” fees triggers the question how far down the line the reporting needs to go. Reporting on the costs borne by the AIFM is a new requirement and it is unclear what benefit that would bring for investors.</p>
<p>Regulatory reporting</p>	<p>AIFMD provisions on regulatory reporting are changed with a view to removing existing “limitations” on the data that competent authorities currently receive, with a proposal for ESMA to replace the current Annex IV reporting template.</p>	<p>These provisions will depend on the detail of the regulatory technical standards. It is possible that ESMA could require more (or even full) portfolio level information in Annex IV reports.</p>
<p>Depositary</p>	<p>National competent supervisory authorities may permit AIFMs to appoint depositaries in Member States other than the home Member States of the AIF. The actual grant of the depositary</p>	<p>The proposal does not grant the long-awaited depositary passport, although it is unclear whether the market would adopt that.</p> <p>In practice, we have seen a small</p>

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	passport is delayed until the subsequent review of the Directive.	number of funds (primarily those investing in rather exotic asset classes (e.g, crypto-funds)) that were launched in jurisdictions which were not the usual jurisdiction of choice, solely because no depositary in the latter jurisdiction existed that offered the right services. In those special situations, a depositary passport would certainly be welcomed.

Proposed Changes to ELTIF Regulation

Topic	Summary
Scope and definitions	<p>The scope of the Regulation is broadened:</p> <ul style="list-style-type: none">• The objective of the Regulation is now to <i>facilitate the raising and channelling of capital towards</i> long-term investments in the real economy, in line with the Union objective of smart, sustainable and inclusive growth.• The definition of Real Assets is less restrictive (“real asset” means an asset that has an intrinsic value due to its substance and properties.• Securitisations have been included in the scope of ELTIF eligible assets (subject to limitations in terms of types and size).• Master-feeder ELTIFs structures are now explicitly included in the text and requirements applicable to master-feeder structures have been broadened.• Eligible Assets have been extended, in particular the maximum value of a listed entity to be eligible has been increased from EUR500 000 to EUR1 billion.

Topic	Summary
ELTIFs marketed to professional	Requirements applicable to ELTIFs exclusively marketed to professional investors have been generally softened, in particular as regards diversification rules and borrowing limits.
Fund of fund	ELTIFs may invest in European alternative investment funds (within the meaning of the AIFMD) managed by European alternative investment fund managers.
ESMA reporting	The scope of reporting that national competent authorities must provide to ESMA has been broadened.
Application	The text clarifies that authorisation shall not be subject either to a requirement that the ELTIF be managed by an AIFM having its registered office in the home Member State of the fund, or that the AIFM pursue or delegate any activities in the ELTIF home Member State.
Conflict of interests	Co-investments by ELTIFs are now expressly authorised. The AIFM (including affiliates and staff) managing an ELTIF may now co-invest in and with that ELTIF (provided that robust conflict of interest policies are put in place).
Portfolio composition and diversification and borrowing limits.	<p>Thresholds for diversification, concentration and borrowing limits have generally been increased and, generally, do not any longer apply to ELTIFs marketed to professional investors.</p> <p>Borrowing limits do not any longer apply when borrowing is secured by uncalled capital commitments. This is a very helpful change generally and one would hope that similar clarifications will be made to AIFs.</p>
Open-ended ELTIFs	Investor redemption rights are now explicitly permitted.
Facilities available to investors	The requirement for ELTIF managers to have facilities in place in the Member States in which the ELTIF is marketed, has been removed.

Topic	Summary
Retail investors	Specific requirements applicable to ELTIFs distributed to retail investors have been removed. Retail investors can now freely invest in an ELTIF, but the MiFID suitability test will apply and ELTIF having an, at least, 10-year term will have to state explicitly they are long-term. There is also a helpful clarification that employees of the ELTIF manager are not considered as retail investors.

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Please do not hesitate to contact us with any questions.

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