

EU Market Integration Proposal and Impact on Alternative Investment Fund Managers

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The European Commission (the “Commission”) recently published a set of legislative proposals named the “Market Integration Package”. The proposals, part of the EU’s broader Savings and Investments Union initiative, intend to further integrate EU financial markets by breaking down barriers to cross-border business and encouraging greater capital flows. As the proposals amend at least 18 separate EU legislative acts, they are of wide interest to market participants. In this In Depth, we focus on the proposals that are relevant to EU AIFMs.

The legislative proposals will need to be agreed by the European Council and Parliament under the EU legislative process and may well be amended before enacted.

In its Impact Assessment, the Commission points to the dominance of Luxembourg and Ireland as fund domiciles and the low market penetration of investment funds in some jurisdictions, such as Italy and Poland. In fact, it is the funds domiciled in Luxembourg and Ireland which predominantly use the AIFMD marketing passport, with limited cross-border distribution of funds domiciled in other jurisdictions. In addition, EU-domiciled funds tend to be significantly smaller than their US counterparts, indicating an overly fragmented market. In this context, the Commission is interested in ways to promote fair competition amongst Member States, to make supervisory practices more consistent and ensure smooth operation of the marketing and management passport system.

Marketing and Pre-Marketing by EU AIFMs

The Commission confirms in its related Impact Assessment Report that supervisory practices with respect to how fund marketing rules under AIFMD are applied vary widely across jurisdictions. For example, the same fund may face different requirements for the content and format of promotional materials across the single market. Funds marketed in multiple EU countries have higher initial and ongoing costs due to the local requirements and market practices imposed by “host” Member States on the marketing of cross-border funds.

The marketing rules are not fully harmonised because they are mainly regulated by Directives, which have to be implemented into national law by Member States and hence lead to some national discretion in some cases.

The Commission proposes to remove from the AIFMD the rules on the marketing passport and pre-marketing applicable to EU AIFMs with EU AIFs and to include these instead in the Cross-Border Distribution of Fund Regulation. As opposed to a Directive, which needs to be implemented into national law by Member States, a regulation applies directly, without national discretion. Marketing rules applicable to non-EU AIFMs and retail investors which are not within the scope of EU harmonisation remain subject to national discretion. Notification and de-notification requirements for marketing and pre-marketing will be streamlined, with shorter processing times for national authorities.

The pre-marketing requirements for EU AIFMs will be simplified. The rules that (i) any subscription by professional investors within 18 months of an EU AIFM having begun pre-marketing in a jurisdiction is considered to be the result of marketing (and therefore subject to marketing notification procedures), and (ii) following a de-notification, an EU AIFM may not pre-market an EU AIF, or a fund with a similar strategy, for a period of 36 months, will be removed.

ESMA will also carry out a review of fees and charges imposed by Member States in relation to marketing of funds by EU AIFMs in their jurisdictions.

Marketing Communications

The Commission's proposals provide ESMA with a mandate to adopt a delegated act specifying the content and format of marketing communications, in particular on the scope of what is considered a marketing communication; the principles on information that is fair, clear and not misleading; the general principles for drafting marketing communications; the description of risks and rewards in marketing communications; the principles on disclosures relating to costs and fees in marketing communications; and information on past and future performance in marketing communications. This delegated act will be crucial, and it is to be hoped that market participants will get the opportunity to contribute constructively.

The Proposal also clarifies that the AIFM is liable for ensuring delegates carrying out the marketing function comply with the marketing communications requirements, whereas distributors acting on their own behalf, and therefore not qualifying as delegates, are themselves responsible. It will be important to have clarity on when an

entity assuming marketing/distribution functions is deemed to be “acting on its own behalf”.

Delegation Requirements

Under current AIFMD, intra-group delegation of functions is treated the same as third-party delegation, requiring AIFMs to carry out due diligence, monitoring and oversight activities when delegating within the same group. To encourage participation in investment management from entities based in all EU states, the Commission proposes to dis-apply the usual conditions on delegation when it occurs intra-group between EU entities (including checks on the delegate’s resources and management, and ongoing supervision) and to only require the manager to notify its home regulator of the arrangements. The “letter-box” principle, and the principle that an AIFM remains liable for any delegated functions, remains. The rule also requires that, to the extent the delegated function is a regulated function, the delegation remains subject to the requirement that the delegate is regulated in its jurisdiction.

Changes to Depositary Requirements

To address national divergences, the ability of EU AIFMs of closed-ended AIFs to appoint “depo-lite” depositaries (depositaries that provide their services as part of their professional activities, which are subject to mandatory professional registration) will no longer be subject to Member State discretion. As a result, all AIFMs will be able to use this option.

The draft also introduces a depositary “passport”, removing the current requirement for the depositary to be established in the same Member State as the fund, provided that the depositary is an authorised MiFID investment firm or credit institution and has been authorised to provide services in other Member States. This will broaden the number of depositaries available for funds, in particular for funds established outside Ireland and Luxembourg. In Ireland and Luxembourg, it is unclear whether funds will change their existing practice of engaging locally based administrators and depositaries.

Operating Requirements

In order to promote consistency of approach for EU AIFMs and supervisors, the Directive proposes that ESMA produce guidelines for new rules of conduct and

prudential rules for EU AIFMs, superseding existing national rulebooks. These guidelines will provide further detail to the existing conduct and prudential rules contained in the AIFMD Level 2 Regulation in areas such as best execution and conflicts of interest and may well be based on the more detailed rules introduced under the Markets in Financial Instruments Directive.

Supervision of EU Asset Management Groups

In its 2025 Consultation on Integration of EU Capital Markets, the Commission proposed different models for ESMA to supervise large pan-EU asset managers and a power for ESMA to intervene in competent authorities' supervision in specific cases, including (i) direct supervision by a single EU supervisor; (ii) the establishment of a supervisory "college" with responsibility for, and taking joint decisions on, the supervision of significant asset managers; and (iii) the establishment of a supervisory "coordination college" comprised of relevant national competent authorities and ESMA, while supervisory responsibilities remain unchanged. Under each model, national competent authorities remain responsible for asset managers with limited or no cross-border activity.

Under the proposed changes in the Directive, ESMA will identify each group which includes an EU AIFM, whose "net asset values" (understood to be assets under management) exceed EUR 300 billion and where the group contains more than one AIFM established in more than one EU Member State or where the AIFM manages or markets funds in more than one EU Member State. For each such large EU asset management group, ESMA will carry out an annual review of the supervisory approaches applied by the relevant national regulators under AIFMD. The Commission's proposal does not involve direct supervision by ESMA or a form of joint supervision between ESMA and national competent authorities. Rather, it establishes a forum for ESMA to assess how a large asset management group is supervised by national authorities and to propose actions that those national authorities should take to address and potentially to exercise its power to issue recommendations and opinions on specific points of EU law to national authorities. In this regard, ESMA is specifically tasked with identifying any "diverging, duplicative, redundant or deficient" supervisory practices.

It is an open question whether large asset management groups will benefit from this new form of supervision. As each entity in a pan-EU group is individually supervised by the local competent authority, the new form of supervision is designed to address conflicts between supervisors or the application of duplicative requirements. Asset management groups typically operate a "hub" structure with a single AIFM, supervised

by a single competent authority, with subsidiaries in other jurisdictions that are typically either authorised under MiFID or exempt from authorisation under a group exemption. It may be that competent authorities that host fund hubs, notably Ireland and Luxembourg, will resist an additional layer of assessment of their activities by ESMA.

Authorization of AIFMs

The Commission has proposed various changes to the way in which AIFMs are initially authorised by competent authorities:

- There will be no restriction on the ability of AIFMs to use human and technical resources of other entities within their EU group to allow efficient use of group operational resources.
- ESMA will provide regulatory technical standards for standard forms (and related IT systems and data standards) for AIFMs' application for authorisation to ensure consistent approaches by Member States.
- The relief for regulatory capital for AIFMs which benefit from a guarantee by an EU credit institution or insurance undertaking or in a third country is not subject to any national discretion.

Host AIFMs

To address the Commission's concerns relating to the use of third-party "host" AIFMs—defined as AIFMs that manage AIFs "at the initiative of a third party"—there are requirements for such AIFMs to indicate at what point of authorisation they intend to manage these types of AIFs, and to demonstrate that they have taken reasonable steps to address any conflicts of interest that arise. This is presumably a reference to conflicts that may arise in managing AIFs on behalf of third parties between the interests of that third party and the AIFM.

Conclusion

The general approach to further harmonise cross-border business for the asset management industry is generally welcomed, but the concern is that this could in some cases lead to even more administrative burdens.

The new rules which recognise that affiliates can use human and technical resources of EU affiliates and the removal of the delegation requirements in case of delegation to an EU affiliate are very helpful and could be a big improvement if accordingly applied by regulators.

There are limited changes to the marketing and pre-marketing rules. The removal of the blocking-out period for pre-marketing in case of a de-notification is highly welcomed. We should monitor that national legislators continue to recognise NPPRs for non-EU fund managers. ESMA's delegated act regarding marketing communications will be very important and hopefully there will be an opportunity for the industry to contribute and comment and help improve the current framework of cross-border marketing communication rules which in many instances do not work very well with the blind pool private funds concept.

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