MEMO# 35403

August 17, 2023

Provisional Agreement on AIFMD and UCITS Review Reached by European Co-Legislators

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TO: Europe Regulatory and Policy Committee RE: Provisional Agreement on AIFMD and UCITS Review Reached by European Co-Legislators

On 19 July, the European Council - under the presidency of the Kingdom of Spain - and the European Parliament - led by Spanish conservative MEP Isabel Benjumea (together, the Co-legislators) agreed to provisional versions of the revised Alternative Investment Fund Manager Directive (AIFMD) and UCITS Directive. The text of the provisional agreement has not yet been made available publicly and will require further work to finalize certain provisions in early September.

With the caveat that the text has not been made public, available information leads us to believe that the more concerning aspects of the original provisions on delegation have been considerably softened, and that on liquidity management tools (LMTs), the primacy of the manager in deciding which tools to use and when has been upheld.

We provide a summary of what we understand to be in the current version.

Background

On 25 November 2021, as part of a broader Capital Markets Union package of legislative proposals, the European Commission proposed revisions to the AIFMD, as well as certain conforming changes to the UCITS Directive. The review targeted a limited number of areas for reform, including delegation, liquidity management tools, depositaries, and loan-originating AIFs.

ICI Global advocated against those aspects of the original proposal that may have led to a restriction in the use of delegation, which has served the UCITS brand well for decades and on which much of the industry relies to access expertise globally on behalf of the end investor and take advantage of economies of scale. ICI Global was also keenly aware of the potential downsides of the Commission's more prescriptive approach to the selection and use of LMTs and worked towards safeguarding managers' ability to determine which tools are appropriate for their UCITS, and under which conditions to activate them.

In June 2022, under French Presidency, the EU member states adopted the [Council General approach] which was used by the Swedish Presidency first and then by the Spanish Presidency as the basis for negotiations with the European Parliament (EP). In February 2023, the EP agreed to its own negotiating position ([ECON report]) and trialogues started soon afterwards.

What was agreed

On delegation

Under Article 7 (Authorization), managers will be required to report to the National Competent Authorities (NCAs) a set of qualitative information on their delegation arrangements (i.e., whether delegation is "full or partial"). This was what ICI global had advocated for.

Under Article 20a (Reporting) managers will be required to report additional information on delegation arrangements, including certain quantitative information (i.e., percent and amount of AUM that has been delegated to each delegate/sub-delegate). However, the agreement does not include any maximum threshold for delegation or any geographic restrictions to delegation. Additionally, the requirement for NCAs to report to ESMA delegation arrangements to third countries where more has been delegated than retained has not been included in the final text.

A modified Recital 8, adopted with input from ICI Global, blunts the impact of the Article 20a quantitative requirements by clarifying that "the data collected on the amounts and percentages of the [AUMs] that are subject to the delegation arrangements concerning the portfolio management functions is for purposes of providing a greater overview of the operation of delegation, and is not on its own an evidential indicator for determining the adequacy of substance or risk management, or the effectiveness of oversight or control arrangements at the level of the manager."

On liquidity management

Under Article 18a, managers will be required to select at least two LMTs (one for MMFs) from a list of eight approved tools. ESMA will be empowered to determine the characteristics of those tools, but the responsibility to activate them will remain with the managers. NCAs will have to power to suspend redemptions only in times of stress.

Other aspects of the provisional agreement

Subject to confirmation in the September technical meetings, we understand that these other aspects were included in the provisional agreement:

Loan-origination funds (LOFs)

LOF will be defined as either "when the investment strategy of the fund is mainly to originate loans" or "when the notional value of the AIF's originated loans represents at least 50% of the net asset value".

LOFs will be subject to an eight-year risk retention requirement with some derogations. Member States will have discretion to prohibit AIFs from servicing consumer credits and originating loans to consumers.

Undue costs

ESMA will have the authority to prepare a report "to help develop a common understanding of 'undue costs'" in the context of the Retail Investment Strategy.

We also understand that the co-legislators agreed to introduce a non-binding recital encouraging fund managers of retail AIFs and UCITS to appoint an independent or non-executive director.

Sustainability

ESMA will develop guidelines on how to avoid misleading names. This will include the name of the fund in the key investor documents (KID). A recital further highlights the need to be fair, clear and non-misleading.

Next steps

In the first half of September, further technical meetings will be needed before the Permanent Representatives of the EU member states can formally endorse the text and send it to the European Parliament's Plenary for final adoption. Barring unforeseen developments, the final parliamentary vote could happen as early as October.

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