

THE AIFMD REVIEW – THE FIRST STAGE IN THE PROCESS COMPLETE

AIFMD¹ requires the European Commission to commence a review of the Directive by July 2017. The first stage of that review is now complete, with the publication on 10 January 2019 by the Commission of the report it had commissioned from KPMG into the operation of AIFMD, intended to 'provide and assess evidence' for the Commission's review.

The report does not necessarily reflect the views of the Commission or prejudice future policy decisions. Rather, the Commission has indicated that it will continue its work on the AIFMD review, focusing on the areas identified in the KPMG report, with the intention of issuing its own report to the EU Parliament and Council on the functioning of the AIFMD during 2020. Accordingly, the key value of the KPMG report is that it gives an early indication of the key topics likely to be covered by the Commission in next year's AIFMD review.

Some of the issues raised in the survey responses reflect our experience and have been raised from time to time since the AIFMD was first implemented, For example, inconsistency in marketing requirements across member states has been evident since 2013, including in relation to the specific areas relating to marketing which are cited in the report. These include divergence in marketing requirements of member states due to inconsistent application of the AIFMD marketing rules, the imposition of additional requirements in individual member states and uncertainty around the definitions of 'marketing' and 'pre-marketing'. These are familiar concerns, as disquiet over the 'patchwork' of marketing requirements has been evident from the advent of the AIFMD. The cross-border distribution of funds proposals², on which political agreement was reached in February 2019, attempt to address some of these issues, although there were also concerns amongst respondents about these proposals, especially the definition of 'pre-marketing' in the context of institutional investors

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¹ The Alternative Investment Fund Managers Directive (2011/61/EU).

² 2018/0045 (COD) for the proposal relating to a Regulation on facilitating cross-border distribution of collective investment funds (COM(2018) 110) and 2018/0041 (COD) for the proposal relating to a Directive on the cross-border distribution of collective investment funds (COM(2018) 92).

The report methodology

Article 69 of the AIFMD requires the Commission to review the application and scope of the AIFMD, its impact on investors, AIFs³ and AIFMs⁴, within the EU and in third countries, and the degree to which its objectives have been met. To this end, KPMG conducted a general survey addressed to the stakeholders that are most affected by the AIFMD - such as AIFMs, depositaries, investors, distributors and asset managers, as well as industry bodies - seeking their views on the AIFMD's requirements, their experience in applying them and their impact on the market. 478 responses were received. Alongside the general survey, an 'evidence-based study' was conducted, to assess the extent to which specific AIFMD requirements have met their objectives. The survey and study were carried out in 15 EU member states⁵, chosen to capture the diverse levels of development in alternative investments across the EU, as well as in countries outside the EU which are important fund domiciles, such as the US and the Channel Islands.

Overall conclusion

In general, the report is positive and, on the basis of the survey responses and analysis undertaken, concludes that for the most part AIFMD has achieved its objective to create an internal market for AIFs and a harmonised and stringent regulatory environment for AIFMs.

There are, however, aspects of AIFMD that have not contributed, or may be counter to, the achievement of these aims. The report cites 'areas of potential weakness', including *inter alia* reporting, disclosures to investors, cross-border marketing, remuneration and investment in non-listed companies. However, the report does not contain any recommendations on whether and if so how these 'potential weaknesses' might be addressed and it remains to be seen whether the Commission will introduce measures to address these.

Key findings from the general survey and evidence-based study

The report is lengthy, running to over 400 pages. Some of the key findings, based on the responses to the general survey and the evidence-based study, relate to aspects of AIFMD that have been raised previously, such as: a lack of harmonisation in certain areas, and issues relating to reporting, leverage, remuneration, depositary functions, asset segregation, disclosure to investors, investments in non-listed companies and passporting regimes. These are summarised in Table 1 below.

Next Steps

The Commission will now continue its review of the AIFMD, taking into consideration the information and conclusions contained in the report alongside other sources of data and further analysis.

The Commission will focus on areas that require further analysis – such as leverage, reporting, where AIFMD rules overlap with other EU requirements or

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³ Alternative investment funds.

⁴ Alternative investment fund managers.

⁵ Austria, Belgium, Cyprus, Czech Republic, Denmark, France, Germany, Hungary, Ireland, Italy, Luxembourg, Malta, Netherlands, Spain and the United Kingdom.

where member states have interpreted rules differently. No details have been given to date as to the direction of future policy or the precise changes that might be made to the AIFMD. More information will be available next year when the Commission issues its reports to the Council and the Parliament. It may issue a public consultation paper in early 2020 and it is unlikely that we will see any legislative proposal earlier than that date.

Table 1: Key findings

<ul style="list-style-type: none"> • Internal market: The report states that AIFMD has played an important role in helping to create an internal market for AIFs and a harmonised and stringent regulatory and supervisory framework for AIFMs.
<ul style="list-style-type: none"> • Achieving the aims of the AIFMD: The provisions (or the detail or application of them) are assessed by the report as having, for the most part, contributed to achieving the specific and operational objectives of the AIFMD, although some have not including <i>inter alia</i> in relation to reporting, disclosures, cross-border marketing, remuneration and investment in non-listed companies.
<ul style="list-style-type: none"> • Inconsistencies across EU member states: AIFMD is not applied consistently across member states, with some (although not all) respondents calling for more harmonisation <i>in certain key areas</i> (such as reporting) to ensure a level playing field. However, few respondents called for full harmonisation (a single rule book) across all AIFMD requirements.
<ul style="list-style-type: none"> • Additional requirements for sub-threshold AIFMs: Several member states apply additional provisions to sub-threshold AIFMs (including requiring full authorisation in some cases). However, as AIFMD provides for national discretion in this regard, isolating and assessing the direct impact of the AIFMD threshold provisions is difficult.
<ul style="list-style-type: none"> • Reporting: A number of points were made by respondents on reporting: <ul style="list-style-type: none"> – The costs incurred by AIFMs on ongoing compliance with the reporting requirements form a significant part of overall transaction and operational costs. – Some AIFMD reporting requirements may not be essential, and some may be insufficient or duplicative. There are also overlapping reporting obligations under other EU legislation and an inconsistent understanding of what needs to be reported. – There are differences between member states on the methods of data delivery and requests from some member states for additional information on a periodic or ad hoc basis. This increases the cost of reporting. – Most national competent authorities said that they monitor and analyse the reported data. However, the analyses are not made public. Some industry respondents called for regular publication of aggregate figures of the reported data, to provide more information on the market to all participants (including investors). – Any future amendments to the reporting requirements should take account of the significant costs in implementing reporting systems and the additional costs that would be incurred in making changes, especially if those changes are made in a piecemeal fashion. – Reporting should be looked at in the round for asset and fund managers and efficient use of new technologies should be considered.
<ul style="list-style-type: none"> • Leverage <ul style="list-style-type: none"> – The evidence-based study, which forms part of the report, concludes that the AIFMD leverage provisions appear effective in the monitoring and mitigation of systemic risks resulting from leverage and most respondent national competent authorities did not express any concerns about the leverage levels they had observed in their jurisdictions. – Some industry respondents called for the harmonisation of the calculation methodologies for leverage across different legislation, e.g. across AIFMD and UCITS. – It was noted that ESMA's Action Plan for 2019 includes work on leverage. Industry respondents suggested that any changes to EU requirements should be considered only after IOSCO's⁶ work in this area is complete and be introduced simultaneously for UCITS and AIFs.

⁶ The International Organization of Securities Commissions.

• **Valuation**

- The binary choice in the valuation rules between internal or external valuation, and the differing national interpretations of the extent of the liability of external valuers may have impaired the effectiveness of the rules for some asset classes and in some member states.
- It was reported that the lack of external valuers in some member states has resulted in lower levels of price competition and that AIFs and AIFMs may face higher charges as a result.

• **Remuneration**

- Data suggested that the remuneration requirements may lack coherence due to overlap with remuneration requirements in other legislation and guidelines (especially for AIFMs that are part of corporate groups having to comply with more than one regulatory regime), which in turn reduces the potential efficiency of the AIFMD regime.
- For some types of AIF there remain additional national provisions.

• **Functional and hierarchical separation**

- The survey and interview results indicate that AIFMD has generally had a positive influence on the limitation of micro-prudential risks as regards conflicts of interests and risk management. AIFMs reviewed and in many cases adjusted their governance, policies and procedures to meet the requirements of AIFMD.
- Some respondents, in particular from the private equity and real estate sectors, questioned the necessity of full functional and hierarchical separation of risk and portfolio management, especially for smaller AIFMs.

• **Depositaries**

- There was an overall sense amongst respondents that the depositary rules adopted a one-size-fits-all approach, which does not accommodate different asset classes or geographies.
- The transitional provision in Article 61(5) AIFMD in relation to the domicile of the depositary was found by some respondents to have been valuable, especially respondents from smaller member states, who urge that it be extended.

• **Asset Segregation**

- There is a high degree of coherence between depositary requirements under AIFMD and UCITS, but the slightly less stringent asset segregation requirements in AIFMD (in particular, in relation to legal opinions) were appropriate for AIFs given the investment needs of EU professional investors⁷. Interviewees observed that the application of even more stringent rules to AIFs could have the effect of precluding AIFs from investing in certain third countries or via certain counterparties, which could in turn lead to professional investors seeking to invest via non-EU AIFs instead.

• **Disclosures to investors**

There were varied responses on this topic.

- Article 23 AIFMD requirements on disclosures to investors are felt to be excessive in quantity and therefore are ignored or prevent investors from obtaining a clear understanding of the AIF's investment proposals.
- On the other hand, some representatives of institutional investors noted that there remain insufficient or non-standardised disclosures of **all** fees, costs and charges in e.g. private equity investment AIFs.
- Some respondents noted that AIFMD investor disclosure rules are inconsistent with other (more recent) EU investor disclosure regimes and give rise to duplicative, and potentially inconsistent, disclosures.

⁷ Note that this has now changed because new legal opinion requirements in relation to delegates in third countries are imposed on AIF Depositaries by the amendments made to the AIFMD Delegated Regulation referred to in footnote 3 above.

- ***Investments in non-listed companies***

The requirements relating to investments in non-listed companies and enterprises received particular criticism from respondents. Comments included:

- The extent of the notifications to national competent authorities is viewed as not useful and overly burdensome (especially given that many private equity/venture capital AIFMs are smaller companies, for whom the administrative burdens may be proportionately greater), requiring disclosures at additional levels of holdings and for more types of portfolio assets than the Second Company Law Directive, and it is not clear what use national competent authorities can or do make of the information.
- Respondents felt that AIFMD has not improved the information provided by the AIF/AIFM to controlled companies or had a positive impact on the relationship between AIFs/AIFMs and target or investee enterprises.
- There was felt to be a lack of clarity in relation to the meaning of 'non-listed company' and the application of the rules to investments in unlisted special purpose investment vehicles and unlisted UCITS or AIFs.

- ***Passporting regimes***

- Statistical evidence indicates that the EU management passport is working well, but the EU marketing passport is lagging behind and is suffering from the different approaches taken by national competent authorities. It is noted that this is recognised in the Commission's proposals on the Cross-Border Distribution of Funds.
- The study notes that member states have adopted different approaches as to which activities constitute "marketing" and there is a lack of transparency on differing national rules and processes. This results in additional costs for the industry and investors and undermines the benefits of the AIF passport.
- In relation to third country marketing issues, for example marketing by non-EU AIFMs and EU-AIFMs marketing non-EU AIFs, the study notes that developments vary markedly from one member state to another, due to the discretion given to the member states by Articles 36 and 42 of AIFMD. Developments appear to be heavily dependent on national measures and demand by professional investors in the member state for non-EU AIFs.
- Some respondents noted that it had been valuable that national private placement regimes (NPPRs) had been permitted to operate.
- Some respondents called for the non-EU (third country) AIFM passports to be introduced and a significant number, from a range of member states and third countries, called for the NPPRs to be retained, even if the non-EU passports are introduced.

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