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FIRM NEWS

Thomson Reuters - Regulatory Intelligence Discusses AIFMD II With Neil Robson

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In an article in *Thomson Reuters - Regulatory Intelligence*, Financial Markets and Funds Partner Neil Robson helped break down the European Council's final compromise text of the revised Alternative Investment Fund Managers Directive (AIFMD II) and Undertakings for Collective Investment in Transferrable Securities Directive (UCITS) amendments, and what it means for hedge fund, private equity, and investment fund managers.

The AIFMD II has a deep focus on transparency. In addition to requiring management companies to provide more information on staff, Neil noted that the "AIFMD II also introduces new obligations on AIFMs who delegate portfolio or risk management functions, both at the point of authorization and as part of their regulatory reports [to the relevant national regulator]." AIFMD II also includes additional AIFM disclosure obligations to investors.

He added that more information will come from the European Securities and Markets Authority (ESMA). "[ESMA] has been tasked with producing regulatory technical standards (RTS) on the frequency and timings that AIFMs will need to report within 36 months of AIFMD II entering into force. How these new requirements will ultimately play out will only become clear once the new RTS on regulatory reporting amends or replaces the current reporting framework."

Neil highlighted the new loan origination rules, which covers the act of loan origination and special requirements for "loan originating AIFs." He stated, "AIFs can originate loans and trade-on those loans on a secondary market, subject to a 5 percent risk-retention requirement, which feels aligned with the EU Securitisation Regulation requirements. This means that these AIFs must, subject to certain carve-outs, retain 5 percent of the notional value of each loan they originate and subsequently transfer to third parties." He explained that the 5 percent must be retained until maturity for loans under eight years or those to consumers, and for at least eight years for all other loans.

AIFMD II prohibits investment strategies where loans are originated solely for transfer to third parties. "AIFMD II's recitals explain that this restriction has been imposed to 'avert moral hazard and maintain the general credit quality of loans originated by AIFs' – in other words, to avoid situations where loans are originated with the sole purpose of selling them."

Loan-originating AIFs have to be closed-ended, with one exception. Neil explained, "An AIFM wishing to manage an open-ended loan-originating AIF may continue to do so but must 'demonstrate' to its home member state regulator that the AIF's liquidity risk management system is compatible with its investment strategy and redemption policy. For open-ended AIFs, leverage is capped at 175 percent, while closed-ended AIFs can go up to 300 percent."

Another major change for AIFMs with open-ended funds and UCITS management companies includes detailed rules about using liquidity management tools (LMTs). "The AIFM will also be required to implement detailed policies and procedures for the 'activation' and 'deactivation' of any selected LMTs and set out the operational and administrative arrangements for using any such LMT. When activating or deactivating an LMT, the AIFM will be under an obligation to notify its home member-state regulator."

Neil indicated that there has been no formal UK AIFMD reform proposals from the Financial Conduct Authority (FCA). "It'll be a case of waiting and seeing what the FCA proposes in 2024."

"Alternative investment funds: Final EU AIFMD 2 text includes transparency rules, lending restrictions," *Thomson Reuters - Regulatory Intelligence*, January 2, 2024

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