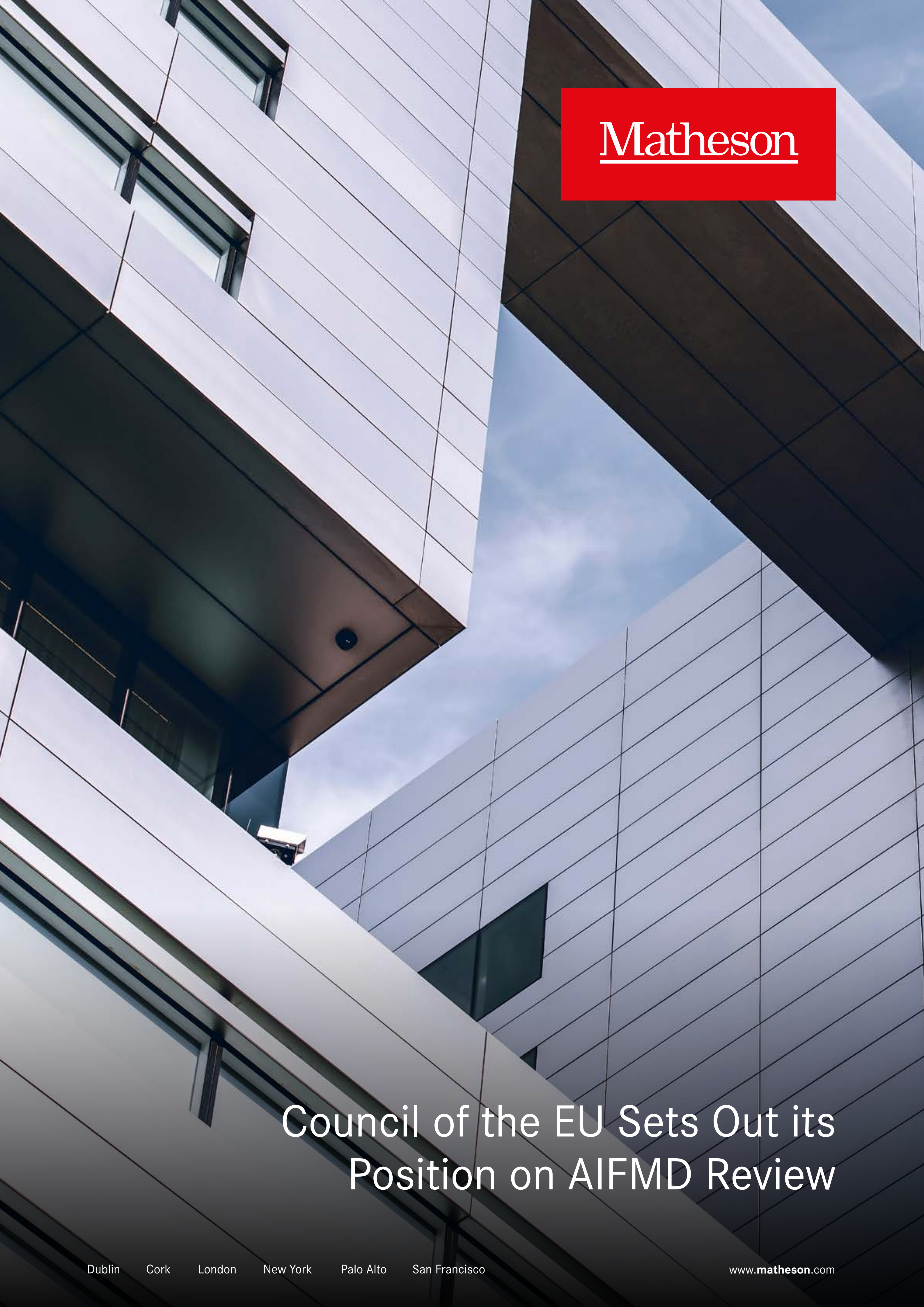

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Council of the EU Sets Out its Position on AIFMD Review

June 2022

The Council of the EU ("**Council**") has published its General Approach on the European Commission's ("**Commission**") proposals to amend the Alternative Investment Fund Managers Directive ("**AIFMD II**"). The European Parliament's Economic and Monetary Committee ("**ECON**") published its report on the proposals in May 2022 and there are many areas of agreement between the Council and the ECON, although the divergences suggest that there is scope for amendments during the trilogue negotiations, which are expected to commence later this year. Many of the proposals, although put forward in the context of the AIFMD review, will also involve amendments to the UCITS Directive.

See our earlier update setting out the Commission's proposals published in November 2021 as part of its Capital Markets Union package. Some of the main changes proposed by the Council are set out below.

Delegation

The Council has proposed that delegation by the alternative investment fund manager ("**AIFM**") (and UCITS management companies) should be subject to additional reporting requirements, in line with the suggestions contained in the ECON report. In line with the Commission's original proposals, neither the Council nor ECON propose the introduction of substantive restrictions on delegation. The Council is prescriptive in relation to the information to be reported, including: information on delegates; the list and description of delegated activities; the amount and percentage of assets that are subject to delegation arrangement concerning the portfolio management function; a description of how the AIFM / UCITS management company oversees, monitors and controls the delegate; information on sub-delegation arrangements; and the date of commencement and expiry of the delegation and sub-delegation arrangements.

While proposing that the amount and percentage of assets subject to delegation arrangements be reported, the Council clarifies that this is for the purpose 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.*"

The General Approach also states that, where the marketing function is performed by one or several distributors acting on their own behalf and not on behalf of the AIFM, this should not be considered a delegation and would therefore not be subject to the delegation requirements.

Loan Origination

The Council has proposed the following amendments in relation to loan origination:

- a new definition of loan origination – "*granting loan by an AIF as the original lender*". This definition could mean that a fund which originates a single loan could be within scope of the loan origination framework, even if loan origination is not its predominant investment focus;
- prohibition on AIFMs managing "originate-to-distribute" AIFs, that is, AIFs with an investment strategy to originate loans or gain exposure to loans through special purpose vehicles with the sole purpose of transferring those loans or exposures to third parties;
- extending the scope of persons to whom an AIF would not be permitted to grant loans to include certain entities within the same group as the AIF;
- member states would be permitted to prohibit loan origination to consumers;
- replacing the Commission proposal that an AIF would be required to be closed-ended if it originates loans exceeding 60% of its net asset value by inserting a general requirement for the AIF to be closed-ended unless its liquidity risk management system is compatible with its investment strategy and redemption policy;
- restriction on lending to a single borrower which is a financial undertaking, an AIF or a UCITS where the loan is in excess of 20% of the AIF's capital – including both loans originated by the managed AIF and by certain SPVs on behalf of the AIF;
- a new limitation on leverage of 150% of the net asset value of the AIF, calculated using the commitment method;
- the Commission's proposed minimum retention requirement of 5% for loans originated by or on behalf of the AIF and sold on the secondary market is retained but would only apply for a two year period (or until maturity if shorter);
- member states will have some discretion in relation to applying the full loan origination regime to private equity or real estate funds granting shareholder loans; and
- a proposed five year transitional period for AIFMs managing loan-originating AIFs which were constituted before the adoption of AIFMD II.

Liquidity Management

The Council proposes requiring AIFMs of open-ended funds to select at least two liquidity management tools (as opposed to one, as proposed by the Commission) unless the AIF is a money market fund.

Dual pricing is added as a further liquidity management tool. The Council does not agree with the Commission's proposal that competent authorities would have the ability to require AIFMs to use certain liquidity management tools in certain circumstances.

AIFM Permitted Activities

The Commission had proposed extending the scope of permitted activities to include benchmark administration (for both AIFMs and UCITS management companies) and credit-servicing (for AIFMs only). The Council suggests that member states should be able to prohibit AIFMs from servicing credits to consumers within their jurisdiction and that AIFMs / UCITS management companies should be unable to administer benchmarks which are used in their managed AIFs.

Disclosure and Reporting

The Council has amended the frequency of some new proposed reporting requirements from quarterly to annually.

Depositaries

The General Approach does not provide for a depositary passport but sets out a limited framework for the provision of depositary services on a cross-border basis for concentrated markets with few providers.

Next Steps

The plenary of the European Parliament will vote on the ECON Report later this year (the vote is expected to take place on 26 September 2022), which should pave the way for trilogue negotiations to commence in Q3 2022. There is, therefore, still scope for some of the more contentious aspects of the proposals, for example the 150% leverage cap for loan-originating AIFs, to be amended. The changes to the AIFMD will apply two years after the entry into force of the amending legislation, expected to be 2024.

Please get in touch with your usual Asset Management and Investment Funds Department contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this update.

Full details of the Asset Management and Investment Funds Department, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at www.matheson.com.

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