



# Proposal to Amend the Alternative Investment Fund Managers Directive - A Closer Look

December 2021

On 25 November 2021, the European Commission (the “EC”) published its [proposal](#) (the “EC Proposal”)<sup>1</sup> for a directive amending the Alternative Investment Fund Managers Directive (“AIFMD”)<sup>2</sup>. The EC Proposal is a key element of the EC’s [Capital Markets Union package](#) with the other proposals relating to: (i) the establishment of a European single access point; (ii) amendments to the ELTIF framework; and (iii) revision of the rules under MiFIR<sup>3</sup>.

In the explanatory memorandum which precedes the text of the draft directive in the EC Proposal, the EC describes the preliminary work that was completed before the EC Proposal was published and notes that the “AIFMD standards for ensuring high levels of investor protection are mostly effective”. Walkers have published a number of advisories on this preliminary work which are available at the following links: [Consultation on the operation of the AIFMD: A quick look at Irish specific feedback and the road ahead](#) and [AIFMD – Room for improvement](#).

Notwithstanding the overarching assessment that AIFMD is “generally meeting its objectives”, the EC have identified a number of areas under AIFMD that could, in their view, be improved. What follows is a brief overview of some of the key proposed amendments to AIFMD described in the EC Proposal.

## 1. Delegation

It is proposed that each national competent authority (“NCA”) would notify the European Securities and Markets Authority (“ESMA”), on an annual basis, where an alternative investment fund manager (“AIFM”) authorised in a relevant member state “delegates more portfolio or risk management to entities in third countries than it retains”.

Couched in terms of assisting ESMA with the mandate it is proposed they be given to review certain matters set out in the EC Proposal, the obligation that NCAs notify ESMA regarding instances where AIFMs are delegating more risk or portfolio management activities than are being retained, potentially is of relevance to a significant number of existing AIFMs, who delegate investment management to non-EU / third country entities.

Delegation arrangements are proposed to be extended to cover all the services listed in Annex I of AIFMD (which would include those add-on services AIFMs are permitted to carry out under MiFID II<sup>4</sup>). Accordingly, AIFMs delegating Annex I services, including ancillary services, would be obliged to notify their NCA and demonstrate how the delegation is justified based on “objective reasons” (as is currently the case when delegating risk or portfolio management).

1. Proposal for a Directive of the European Parliament and of the Council amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services and loan origination by alternative investment funds (2021/0376 (COD)).
2. Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.
3. Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.
4. Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.



## 2. Letter Box Entities

ESMA has been given a very specific role in monitoring the enforcement of the rules under AIFMD which seek to prevent AIFMs from being “letter box entities” i.e. delegating risk or portfolio management responsibilities to such an extent that they divest themselves of their material responsibility in respect of those core AIFMD activities. As part of that mandate ESMA is required to peer review NCA supervision of delegation arrangements every two years and report to the European Parliament (the “EP”) and the Council of the European Union (the “Council”) on their findings. ESMA are then mandated to carry out a separate review after 5 years to identify how the delegation framework under AIFMD has assisted with the prevention of letter-box entities.

## 3. AIFM Substance Requirements

The EC Proposal sets out the intention to amend AIFMD to require AIFMs to provide, as part of the NCA authorisation process, detailed information on the human and technical resources that will be utilised in connection with the applicant AIFM’s business activities. With this, the EC are proposing that AIFMs employ or otherwise engage a minimum of two EU resident persons to conduct the business of the AIFM on a full time basis.

From an Irish perspective these rules are consistent with the Central Bank of Ireland’s existing approach to minimum substance requirements for AIFMs.

## 4. National Private Placement Regimes (“NPPRs”)

The EC Proposal seeks to tighten the conditions that apply in relation to access by non-EU AIFMs and non-EU AIFs of the NPPR in each EU member state. Under the EC Proposal, access to NPPRs under Articles 36 and 42 of AIFMD will require that:

- » non-EU alternative investment funds (“AIFs”) and non-EU AIFMs are not domiciled in a country which is deemed a “High Risk Jurisdiction” pursuant to the Fourth Anti-Money Laundering Directive<sup>5</sup>; and
- » the jurisdiction in which a relevant non-EU AIFM or non-EU AIF is domiciled has signed an agreement with the relevant EU member state undertaking to comply with the standards under Article 26 of the OECD Model Tax Convention on Income and on Capital, thereby ensuring the effective exchange of information on tax matters and that the relevant non-EU jurisdiction is not on the EU’s list of non-cooperative tax jurisdictions.

The requirement in relation to agreeing to comply with the OECD Model Tax Convention is already a requirement under the AIFMD.

## 5. Loan Origination

Under the EC Proposal, loan origination is to be added to the list of activities which can be undertaken by authorised AIFMs. This is supplemented by newly proposed additional non-core services such as “servicing special purpose securitisation vehicles”, “benchmark administration” and “credit servicing”.

In addition, the EC Proposal seeks to put in place rules in relation to the maintenance of specific loan origination policies and procedures in relation to the granting of loans, the assessment of credit risk and sets out prohibitions on lending to certain types of borrowers, including the AIFM, the loan originating AIF’s depositary and their delegates. Specifically, a loan originating AIF would be prohibited from lending more than 20% of its capital to a single borrower which is a financial undertaking or a fund.

Under the EC Proposal, the loan originating AIF would be obliged to retain an interest of 5% of the notional value of any loan it originates which is sold on the secondary market.

There are also: (i) rules in relation to ensuring a loan-originating AIF is closed-ended where more than 60% of that AIF’s NAV is comprised of loans originated by the AIF; and (ii) provisions in relation to the regular reporting of the portfolio composition of originated loans to investors.

From an Irish perspective, the Central Bank of Ireland rules in relation to loan-originating AIFs already cover much of what is set out in the EC proposal and in some cases are more restrictive / goes further than the provisions being proposed by the EC.

5. Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC.



## 6. Depositaries

While stopping short of proposing an EU-wide passport for depositaries, the EC Proposal does contain measures that would facilitate an AIF in one member state procuring the services of a depositary in another member state. These measures are proposed to be put in place pending a further review of the feasibility of introducing depositary passport provisions.

There are provisions in the EC Proposal which will see central securities depositaries being deemed delegates of a depositary (which has not been the case to this point). This change is to facilitate depositaries having better access to information with a view to ensuring enhanced protection for investors.

## 7. Liquidity Risk Management

Managers of open-ended AIFs will need to consider the liquidity management tools available in a new Annex V to AIFMD. In addition to being permitted to suspend the repurchase or redemption of the shares or units of such AIFs temporarily in exceptional circumstances, it is proposed that managers of such AIFs would be required to choose at least one other liquidity management tool that could be activated should circumstances so require.

The EC Proposal includes specific amendments to Article 16 of AIFMD. These amendments propose that AIFMs implement specific policies and procedures in relation to the activation or deactivation of liquidity risk management tools, which should include a description of the operational and administrative arrangements for using a liquidity risk management tool.

ESMA will also have broad power to activate liquidity risk management tools with respect to any AIF.

We expect industry will want additional clarity as the circumstances in which ESMA will be able to use the powers set out in the EU Proposal to activate liquidity management tools, to include specific information on any quantitative or qualitative criteria which triggers its ability to intervene.

## 8. Annex IV Reporting

AIFMs will be relieved that there are no significant proposals to increase reporting obligations under Annex IV of AIFMD in the EC Proposal. However, there have been some tweaks, summarised as follows:

- » whereas previously an AIFM was obliged to report on the “principal” markets, “main” instruments and “principal” exposures that applied in relation to AIFs under management, the EC Proposal seeks to delete the references to “principal” and “main” (among other deletions), meaning that reporting would now need to cover all markets, instruments and exposures; and
- » ESMA has been mandated to produce regulatory and implementing technical standards to reflect changes to the Annex IV reporting template.

## Conclusion

While we have focused on the changes to AIFMD, the EC Proposal also sets out mirroring changes to the UCITS Directive<sup>6</sup>, except most notably, in the areas of loan originating funds and cross-border depositary services.

The EC Proposal is set to be considered by the EP and by the Council. Once the text is agreed by those bodies, there will be further discussions between the EC, the EP and the Council, before the measures set out in the EC Proposal are adopted and published in the Official Journal of the European Union (the “Journal”). Under the current provisions set out in the EC Proposal, member states will need to transpose these measures into local legislation within 24 months of the publication of these measures in the Journal. Accordingly, it is estimated that these measures (as may be altered during the European legislative process), will enter into force across the EU in late 2024 or early 2025 at the earliest.

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6. Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).



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