

E-BOOK



Understanding AIFMD II: A comprehensive guide



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Introduction

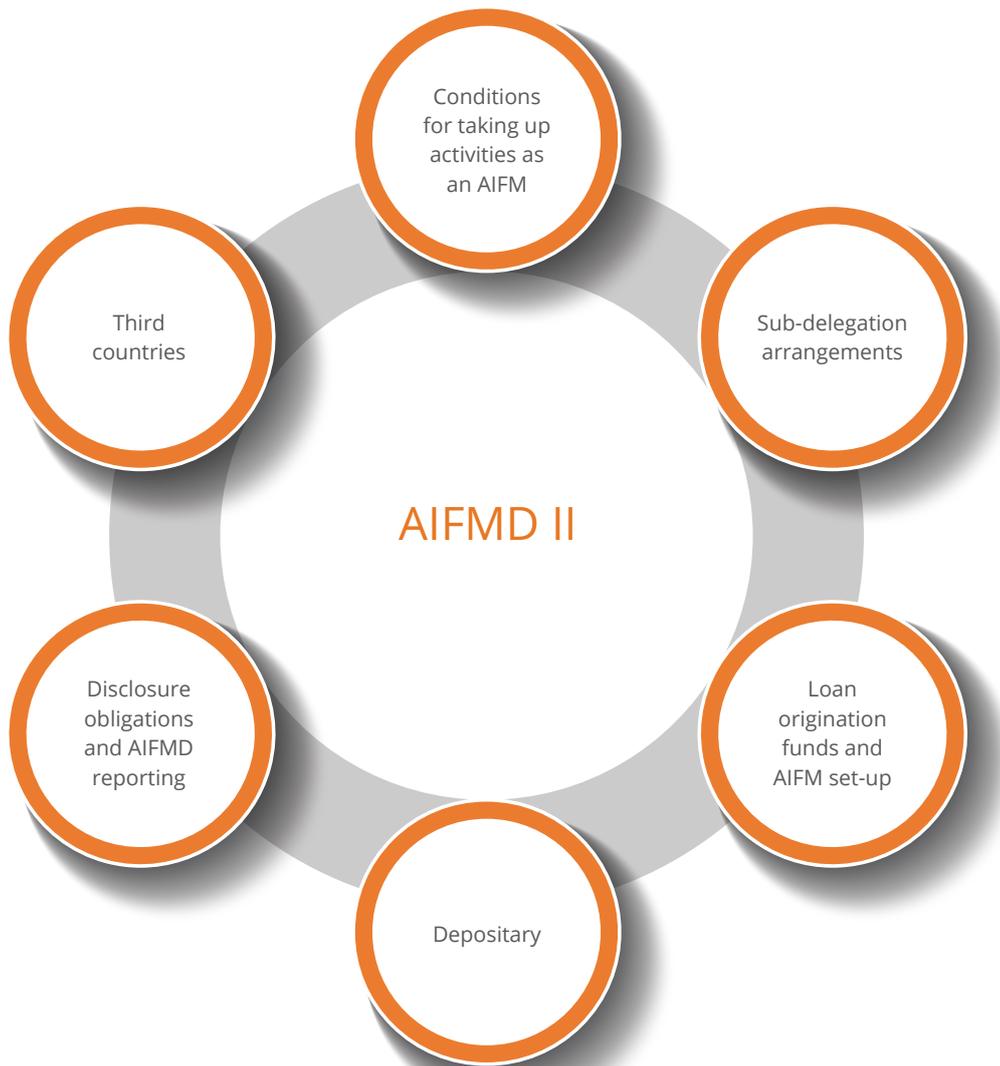
The Alternative Investment Fund Managers Directive (“AIFMD”) has been a significant regulatory framework in Europe, governing alternative investment fund managers and the distribution of alternative investment funds. In this eBook, we delve into the recent developments with the adoption of AIFMD II, exploring its implications, changes, and what it means for stakeholders in the financial industry.



1. Adoption of AIFMD II

On February 7 2024, the European Parliament adopted the legislative texts revising AIFMD (more specifically, Directives 2011/61/EU and 2009/65/EC) regarding delegation, liquidity risk management, supervisory reporting, the provision of depositary, and custody services, and loan origination by alternative investment funds. Subsequently, on February 26 2024, the Council of the EU adopted the proposed changes for AIFMD II, with the final text published to the EU Official Journal on March 26 2024.

The revised text will impact the following areas of AIFMD:



2. Changes in AIFMD II

2.1 Conditions for AIFM activities

The changes made to Article 6 of the Directive involve expanding the scope of non-core services that an AIFM can provide. Specifically, two additional activities are proposed to be included:

1. Administration of benchmarks pursuant to the Benchmarks Regulation, and
2. Credit servicing activities pursuant to Credit Servicers Directive.

These changes aim to enhance the operational capabilities of AIFMs and potentially offer them more diversified business opportunities.

However, AIFMs will not be allowed to provide administration of benchmarks that are used within the AIFs they manage.

Coupled with these changes are enhanced substance requirements introduced in the AIFM application process. As such, applicants will be required to provide information on:

- Senior management and the time allocation for each role, as well as the expertise and the support senior management will receive;
- The delegation arrangements that the AIFM proposes to enter into, along with a description of the periodic due diligence measures to be carried out by the AIFM to monitor the delegated activity.

A condition for granting approval is that the 'conduct of the business of the AIFM is decided by at least two natural persons meeting such conditions, who either are employed full-time by that AIFM or are executive members or members of the governing body of the AIFM committed full-time to conducting the business of that AIFM and who are domiciled in the Union' (Article 8(1)(c)).

The revised Directive also proposes to revise Annex I, which lists the functions an AIFM can perform. In addition to the core functions relating to portfolio management and risk management, the additional functions which the AIFM may be perform have been increased to include:

1. Originating loans on behalf of the AIF and
2. Servicing securitisation special purpose entities.

2.2 Delegation arrangements

Article 20 has been revised to allow AIFMs to delegate to third parties either one or more of the core functions referred to in Annex I or any of the non-core services listed in Article 6(4) of the Directive. Nonetheless, the AIFM is expected to ensure that the performance of the functions referred to in Annex I or the provision of services of Article 6(4) comply with the provisions of the AIFMD, and this obligation subsists irrespective of the regulatory status or jurisdiction of the delegate.

2.3 Loan originating funds ("LOFs")

By far, the introduction of loan originating activities as part of the investment strategies that can be implemented by an AIFM is one of the most important changes that the review of AIFMD has brought about.

Such a strategy requires the following:



Risk management

- (i) Effective policies, procedures, and processes for the granting of loans
- (ii) Effective policies and procedures for assessing credit risk and for administering and monitoring their credit portfolio



Liquidity management

- (i) Loan originating AIF shall be closed-ended or with a liquidity risk management system which is compatible with its investment strategy and redemption policy
- (ii) In the case of an open-ended AIF, the AIFM shall select at least two appropriate liquidity management tools [Annex V]
- (iii) Policies and procedures for activation and deactivation of any selected liquidity management tool



Disclosure obligations [Article 23]

- (i) All costs and expenses linked to the administration of the loans shall be disclosed in full
- (ii) Inclusion of the liquidity management tools in offering documents

The proposed text also introduces investment restrictions:

- Limits on the notional value of the loans originated to any single borrower – this should not exceed, in aggregate, 20% of the capital of the AIF where the borrower is (a) a financial undertaking, (b) an AIF, or (c) a UCITS*,
- The leverage of a loan-originating AIF represents no more than 175% where the AIF is open-ended and 300% where the AIF is closed-ended.

The AIFM shall ensure that a loan-originating AIF, does not grant loans to:

- The AIFM or members of staff of the AIFM,
- The depositary of the AIF,
- Any entity to which the AIFM has delegated functions in accordance with Article 20 AIFMD,
- An entity within the same group.

Furthermore, the AIFM shall ensure that the AIF it manages retains 5% of the notional value of each loan that the AIF has originated and subsequently transferred to third parties, and the percentage of each loan shall be retained for the duration prescribed in the Directive.

What will be the situation for loan funds that were already established?

Article 61 of the revised text, providing for transitional provisions, states that AIFMs managing loan funds already constituted before the coming into force of the revised Directive will have a **5-year transitional period** to comply with the requirements outlined above. In addition, the following scenarios are being proposed:

5 year transitional period		The notional value of the loans originated by the AIF to any single borrower or the leverage of an AIF is above the indicated thresholds		AIFM shall not increase the value or the leverage
5 year transitional period		The notional value of the loans originated by the AIF to any single borrower or the leverage of an AIF is below the indicated thresholds		AIFM shall not increase the value or the leverage
AIF constituted before date of coming into force of revised Directive		No additional capital raised after said date		AIF deemed to be compliant - AIFM may still opt to be compliant

* This limit shall be without prejudice to any thresholds. Restrictions and conditions set out in Regulations (EU) 345/2013 on European Venture Capital Funds; (EU) 346/2013 on European Social Entrepreneurship Funds; and (EU) 2015/760 on European Long-Term Investment Funds.

2.4 Depositary arrangements

Another important change brought about by the revised text relates to Article 20, which deals with the appointment of the depositary and the rule that the depositary must be in the Member State of the AIF. The home Member State of an AIF may allow a derogation from such rule, thereby permitting a depositary established in another Member State to be appointed, provided a number of conditions outlined below are fulfilled:



Submission of a reasoned request from the AIFM to allow the appointment of a depositary established in another Member State. The request must demonstrate the lack of depositary services in the home Member State of the AIF, which are able to meet effectively the needs of the AIF, considering its investment strategy.



The aggregate amount in the national depositary market of the home Member State of the AIF of assets entrusted for safe-keeping on behalf of EU AIFs authorised or registered under the national law, and managed by the EU AIFM, does not exceed €50 billion.

Competent authority shall accede to such requests on a case-by-case basis.

2.5 Disclosure obligations

As indicated earlier, Article 23 is also being revised to enhance the disclosure obligations, especially those relating to:

- Liquidity risk management and the liquidity risk management tools used for loan origination AIFs,
- Fees, charges, and expenses borne by the AIFM in connection with the operation of the AIF or those indirectly allocated to the AIF,
- Loan origination portfolio, including fees borne directly or indirectly by investors,
- Special purpose vehicles used in relation to AIF investments by or on behalf of the AIFM.

In relation to the reporting obligations or Annex IV reporting, as more commonly known, the information to be reported shall include the following:

- Information on the instruments in which it is trading, on markets of which it is a member, or where it actively trades, and on the exposures and assets of each AIF. That information shall include the identifiers necessary to connect the data provided on assets, AIFs, and AIFMs to other supervisory or publicly available data sources,
- Information on the total amount of leverage employed by the AIF,
- Prescribed information regarding delegation arrangements concerning portfolio management or risk management,
- The list of Member States in which the units or shares of the AIF are actually marketed by the AIFM or by a distributor acting on behalf of the AIFM.

2.6 Third Countries

Throughout the provisions of the revised text, any references to the FATF non-cooperative country and territory list have been replaced by the EU list of non-cooperative jurisdictions for tax purposes.

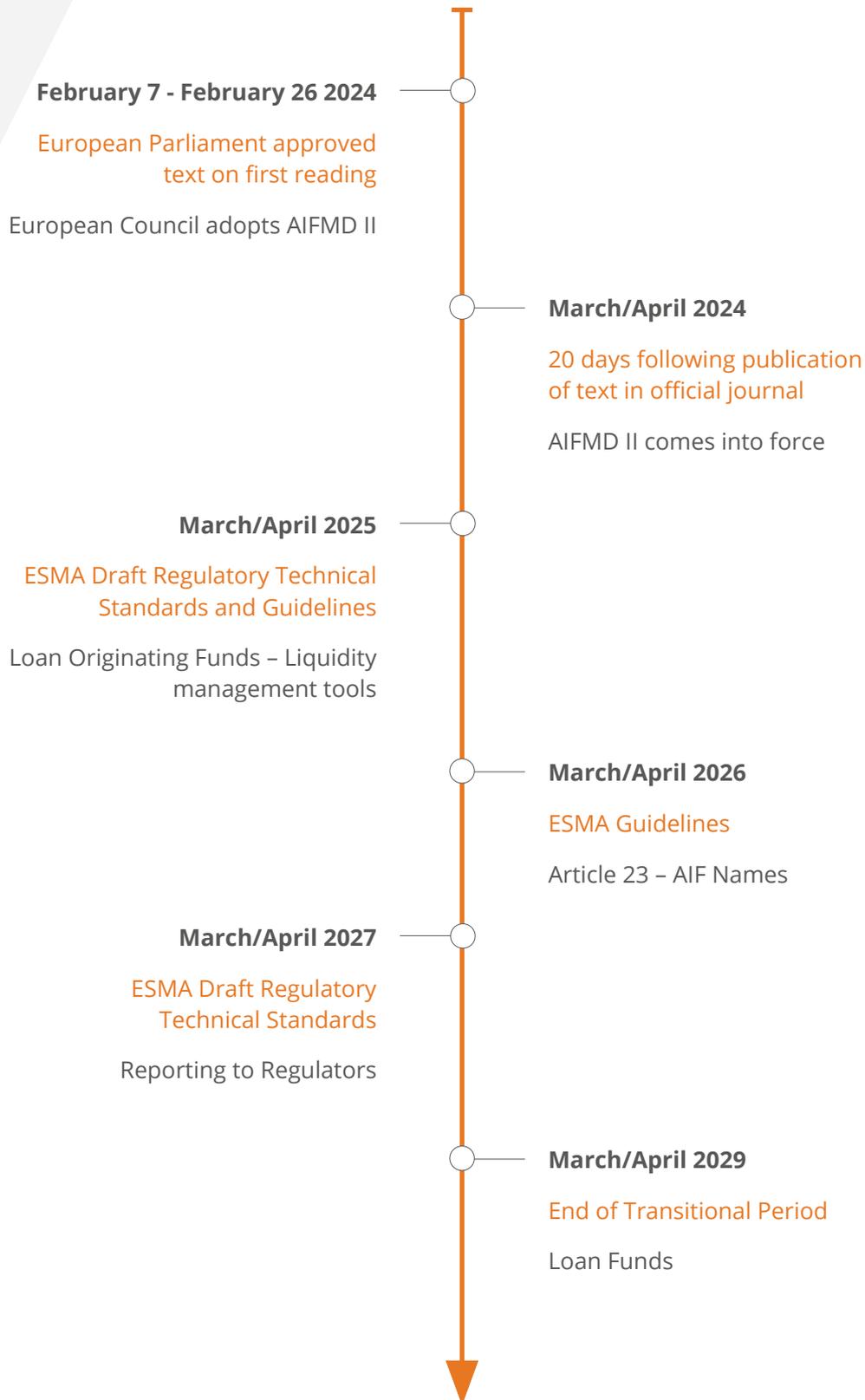
Key highlights of AIFMD II

- **Expanded scope of activities**
Expansion in the scope of activities that AIFMs can undertake, including administration of benchmarks and credit servicing.
- **Delegation arrangements**
Revised delegation arrangements, allowing AIFMs to delegate core functions and non-core services to third parties while ensuring compliance with regulatory provisions.
- **Loan originating funds**
LOFs will be required to retain an economic interest of 5% of the notional loan value and be held for specific periods.
- **Depository arrangements**
Depositaries will no longer be required to be established in the same Member State as the relevant EU AIF, under specific conditions.
- **Disclosure obligations**
Enhanced disclosure obligations, particularly regarding liquidity risk management, fees, charges, expenses, and reporting requirements under Annex IV.
- **Alignment with third countries**
Aligns references to non-cooperative jurisdictions with the EU list of non-cooperative jurisdictions for tax purposes, ensuring consistency in regulatory standards.

3. What should we expect?

The focus now shifts to ESMA and its obligations both before and after the implementation of AIFMD II. Below is a timeline of the regulatory technical standards/guidelines that we should expect.

3.1 Timeline of expected regulatory guideliness



3.2 Post coming into force of AIFMD II

Article No	Report	Timeline
Article 7	ESMA shall provide the European Parliament, the Council, and the Commission with a report on market practices regarding delegation and compliance with paragraphs 1 to 5 of this Article and with Article 20. This report will be based, inter alia, on the data reported to the competent authorities in accordance with Article 24(2), point (d), and on the exercise of ESMA's supervisory convergence powers. Additionally, the report shall assess compliance with the substance requirements of the Directive.	60 months from the date of entry into force of the revised text.
Article 12(1)(f) (Duty to treat investors fairly)	ESMA shall submit a report to the European Parliament, the Council, and the Commission assessing the costs charged by AIFMs to the investors of the AIFs that they manage and explaining the reasons for the level of those costs and for any differences between them, including differences resulting from the nature of the AIFs concerned. As part of that assessment, ESMA shall review, within the framework of Article 29 of Regulation (EU) No 1095/2010, the appropriateness and effectiveness of the criteria set out in the ESMA convergence tools on the supervision of costs.	18 months from the date of entry into force of the revised text
Article 50	ESMA shall develop guidelines providing indications to guide the competent authorities in their exercise of the powers set out in Article 46(2), point (j), and indications as to the situations that might lead to the requests referred to in paragraphs 5b and 5f being put forward. When developing those guidelines, ESMA shall consider the potential implications of such supervisory intervention for investor protection and financial stability in another Member State or in the Union. Those guidelines shall acknowledge that the primary responsibility for liquidity risk management remains with AIFMs.	24 months from the date of entry into force of the revised text

4. What is next?

AIFMD II represents a significant evolution in the regulatory landscape for alternative investment fund managers and funds in Europe. AIFMD II does not seek to overhaul the entirety of AIFMD but instead has sought to make targeted amendments to particular areas under AIFMD. Understanding these changes and ensuring compliance is essential for all stakeholders. Member States will have until 16 April 2026 to transpose the rules into national legislation.



5. How can we help?

We can help you stay compliant with the latest regulations. Get in touch for further information on:

- AIFMD II training
- Compliance and AML monitoring
- Risk and liquidity management monitoring
- Structuring of loan origination funds
- Gap analysis on loan origination provisions

For more information on how the changes to AIFMD will impact your business, please get in touch with a member of our team.





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