Legal Update

AIFMD Reform Proposals Approved

Last week, the European Parliament's Committee on Economic and Monetary Affairs ("ECON") approved a large majority of the revisions proposed by the European Commission to the Alternative Investment Fund Managers Directive ("AIFMD") with a view to developing the EU's Capital Markets Union and strengthening the EU on the international stage. These revisions should also make the pre-existing legislative framework more flexible.

Background

The AIFMD was adopted in 2011 in response to the global financial crisis, which had exposed weaknesses and vulnerabilities in certain fund activities that were viewed as potentially amplifying risks to the broader financial system. The AIFMD provides rules for authorising, supervising and overseeing the managers of essentially all non-UCITS funds including hedge funds and private equity.

The European Commission conducted a review of the application of the scope of the AIFMD as mandated by Article 69 thereof.

Revisions Approved

The ECON has voted to update the rules on delegation, liquidity management, risk management and loan origination to make the industry more attractive to foreign capital, as well as to foster its development. The proposal will therefore:

- Improve the system of delegation of portfolio management and risk management activities to external specialists. ECON recognises the immense value of allowing fund managers source the necessary expertise in a particular geographic market or asset class while promoting transparency of information. The proposal will require regulatory reporting around delegation arrangements, including how the AIFM oversees, monitors and controls the delegate.

- Recognise that liquidity management is the ultimate responsibility of the manager, who has the greatest knowledge and ability to make decisions on investment strategies and choice of liquidity management tools.

- Encourage reliance on private credit and loan origination funds as an activity to attract capital and help finance the real economy in the EU.

However, the proposal imposes a requirement on AIFMs to ensure the leverage of a loan-originating AIF it manages represents no more than 150% of the net asset value of the AIF. This level would be calculated using the commitment method rather than the gross method.

Borrowing arrangements which are temporary in nature and are fully covered by contractual capital commitments from investors in the AIF would not constitute leverage for the purpose of this limitation.

The reforms are aimed at keeping a correct balance between the diversification of investment opportunities, the growth of markets and the maintenance of financial stability.

Looking Forward

These revisions of the AIFMD appear to represent a move toward increased supervisory convergence at an EU-level, thus ensuring that the AIFMD is applied in a consistent manner and that investors receive the highest standards of protection.

The next stage of the legislative process will consist of the Council of Ministers agreeing a final negotiating position on the reforms. The European institutions are due to begin trialogue discussions in the coming weeks.

With a two-year transitional period, applicable for member states after the amendments to the AIFMD are finalised by the EU institutions, implementation will be in 2025 at the earliest.

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