

## **AIFMD Review - ESMA Letter to the European Commission.**

### **Introduction**

In August 2020, the European Securities and Markets Agency (“ESMA”) wrote a letter to the European Commission (“the Commission”) in relation to its impending review of AIFMD. ESMA detailed nineteen areas, which it believes the Commission should consider as part of its review. A synopsis of some of the key points in the letter is provided below.

### **Harmonisation of AIFMD and UCITS Regimes**

ESMA highlights that in some cases the newer AIFMD provisions are more detailed or specific compared to UCITS requirements. It states that the Commission should consider aligning the frameworks where appropriate, as applying different requirements to management companies, which manage both UCITS and AIFs, creates issues for firms. ESMA also suggests that AIFMD and UCITS reporting should be more aligned once AIFMD Annex IV reporting requirements have been improved.

### **Scope of Additional MiFID Services and Application of Rules**

ESMA highlights that member states have different rules relating to the MiFID “top up” services which AIFMs and UCITS management companies are permitted to perform. ESMA also emphasises the importance of ensuring that AIFs/UCITS, their managers and MiFID investment firms always remain subject to the same regulatory standards while providing the same type of services.

### **Delegation and Substance**

ESMA notes that delegation of portfolio management functions to non-EU entities is likely to increase from 2021 following the end of the UK’s Brexit transition period. Such high levels of delegation arrangements may result in a situation where the majority of human and technical resources needed for day-to-day operations are maintained by several third parties or even a single third party potentially outside of the EU. They are also concerned that the majority of staff would not be directly employed by the authorised AIFMD or UCITS management company.

ESMA requests the EU Commission to address a number of items such as to:

- Provide further clarity on the maximum extent to which an AIFM may delegate its functions.
- Make legislative amendments so that delegates in jurisdictions not directly subject to AIFMD/UCITS are subject to the regulatory standards of the AIFMD/UCITS frameworks. This is to avoid regulatory arbitrage.
- Clarify as to the types of secondment arrangements that are acceptable under AIFMD. ESMA has concerns about the increased prevalence of professional service firm consultants being seconded into AIFMs.
- Clarify if the delegation by AIFMs of “other functions” such as administration and marketing are subject to the same rules on delegation which apply to investment management functions such as portfolio management and risk management.
- Confirm if the third-party AIFM model is permissible under AIFMD. ESMA suggests that if it is, a specific set of rules should be introduced to govern third-party AIFM arrangements.

### **Timeline for National Competent Authorities (“NCAs”) to Update the ESMA Register**

The letter states that the proposed quarterly update of the ESMA register limits the value of the information provided to investors, market participants and financial supervisors, as information on recent authorisations /withdrawals are not available in a timely manner. ESMA suggests the ESMA register is updated monthly.

### **Semi-professional Investors**

ESMA contemplates the introduction of a ‘semi-professional investor’ concept in the AIFMD and states that any such introduction should be accompanied by appropriate investor protection rules. It states that marketing under an AIFMD marketing passport should remain restricted to ‘professional investors’.

## Loan Origination in AIFMD

ESMA believes that there should be a specific framework for loan origination within the AIFMD. The proposed framework should cover the process for the authorisation of loan origination funds, the types of funds that may undertake such activities and the investors that may invest in loan origination funds.

## Proportionality Principle for Remuneration Requirements

ESMA requests the EU Commission to revise both the UCITS and AIFMD frameworks to clarify that the proportionality principle applies to all of the remuneration rules. This is to ensure that the quantitative variable remuneration thresholds and pay-out structures are only applied where it is proportionate to do so taking into account the size, nature, scope and complexity of the activities of the relevant UCITS management company/AIFM.

## Sub-threshold AIFMs

The letter outlines that AIFMD exempts small AIFMs from most of the Directive but leaves discretion to member states on what to require from such sub-threshold AIFMs. Consequently, ESMA recommends that the Commission should consider further clarifying the power of member states to apply additional requirements under their national laws to sub-threshold AIFMs.

## External Valuer Liability

Under the AIFMD legislation it states that “*the external valuer shall be liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer’s negligence or intentional failure to perform its tasks*”. ESMA emphasises that in certain jurisdictions the reference to negligence is interpreted as covering not only ‘gross negligence’ but also ‘simple negligence’, acting as a disincentive for external valuers to provide services due to liability concerns. ESMA believes that AIFMD should be updated to reference a standard of “gross negligence” instead of negligence.

## Clear Definition and Rules for Reverse Solicitation

ESMA stresses within the letter the importance of clarifying the notion of reverse solicitation. It believes it is currently subject to divergent practices and interpretation at national level. ESMA requests that the concept be clarified to protect investors.

## Depositary Passport

While not recommending the creation of such a passport in AIFMD and the UCITS Directive, ESMA believes the Commission should study the benefits and risks further in the context of the AIFMD Review.

## Next Steps

The Commission is expected to issue a consultation on its proposed changes to AIFMD in Q4 2020. If ESMA's recommendations are taken on board by the Commission, then they are likely to be included in the Commission's consultation. This will provide an opportunity for AIFMs and UCITS management companies to comment on these and other proposals.

## KB Associates Services

KB Associates provides a range of services to investment funds including:

- The provision of UCITS management company/AIFM services
- The provision of designated persons to perform UCITS business plan/AIFMD programme of activity functions.
- The provision of operational and compliance services to both UCITS and AIFMD compliant structures.

If you would like to discuss this note or KB Associates’ services in general, please contact:

- Mike Kirby (+353 1 667 1980, [mike.kirby@kbassociates.ie](mailto:mike.kirby@kbassociates.ie))
- Andrew Kehoe (+353 1 613 6396, [andrew.kehoe@kbassociates.ie](mailto:andrew.kehoe@kbassociates.ie).)