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AIFMD 2.0 is on the way

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Following political agreement during the summer, in November 2023, the Council of the EU (“**Council**”) published the final text of the directive amending the Alternative Investment Fund Managers Directive (“**AIFMD**”) and the UCITS Directive (we will refer to the amending directive as “**AIFMD 2.0**” in this briefing note). We have set out below the key changes introduced to both the AIFMD and UCITS framework.

### Authorisation

In an effort to harmonise requirements in member states with regard to substance, the recitals to AIFMD 2.0 require that AIFMs and UCITS management companies (fund management companies or “**FMCs**”) should provide information when applying for authorisation about the human and technical resources it will employ to carry out its functions and supervise its delegates. The recitals state that at least two EU-resident natural persons who are employed by the FMC or are executive members or members of the board should be appointed to conduct the business of the FMC. It is acknowledged that this is a minimum and that more resources may be necessary depending on the size and complexity of the FMC. This does not alter the current Irish position, as the Central Bank’s expectation, as set out in its [Dear Chair letter](#) of October 2020, is that FMCs should have a minimum of three full time employees and specifies that this is a minimum expectation only.

### Delegation

While the European Securities and Markets Authority (“**ESMA**”) has in the past expressed reservations about delegation from a risk oversight perspective, and some member states believe restrictions ought to be introduced in order to relocate portfolio management activities within the EU, the text of AIFMD 2.0 acknowledges the role of delegation in allowing for the efficient management of investment portfolios and for accessing necessary expertise in particular geographic markets or asset classes. No new restrictions on delegation are included, although FMCs will be subject to increased reporting requirements in relation to delegation arrangements.

The amended provisions relating to delegation will require FMCs to report their delegation arrangements to NCAs on authorisation and as part of their regular regulatory reporting. The information to be reported as part of the authorisation process will include:

- the legal name, legal identifier, jurisdiction of establishment and, where relevant, the supervisory authority of the delegate;

- a detailed description of the resources employed by the FMC for performing day-to-day portfolio or risk management tasks within the FMC and for monitoring the delegated activity;
- a brief description of the delegated portfolio management and risk management functions, including whether the delegation amounts to a partial or full delegation; and
- a description of the periodic due diligence measures to be carried out by the FMC for monitoring the delegated activity.

The regulatory reporting will include:

- the legal name, legal identifier, jurisdiction of establishment and, where relevant, the supervisory authority of the delegate and whether they have any close links with the FMC;
- the number of full-time equivalent human resources employed by the FMC for performing day-to-day portfolio or risk management tasks within the FMC;
- a list and description of the activities concerning risk management and portfolio management functions that are delegated;
- where portfolio management is delegated, the amount and percentage of the AIF's assets that are subject to delegation arrangements;
- the number of full-time equivalent human resources employed by the AIFM to monitor the delegation arrangements;
- the number and dates of periodic due diligence reviews carried out by the AIFM to monitor the delegated activity, a list of issues identified and, where relevant, the measures adopted to address those issues and the date by which those measures are to be implemented;
- where sub-delegation arrangements are in place, the information required in the first three bullet points in respect of the sub-delegates and the activities that are sub-delegated; and
- the commencement and expiry dates of the delegation and sub-delegation arrangements.

Under the final provisions, ESMA is required to draw on supervisory reporting to “*receive more complete information on the application of this Directive including in the area of appropriate oversight and control of the delegation arrangements, in all Member States*”. ESMA must prepare a report analysing market practices on delegation, substance requirements and compliance with the EU's delegation requirements, which must be provided before the next review of the AIFMD and UCITS Directive. The EU legislators will use this report to assess whether further measures in relation to delegation are deemed to be required in a future iteration of the AIFMD / UCITS Directive.

## Liquidity Risk Management

FMCs must select at least two liquidity management tools (“**LMTs**”) from a list of LMTs set out in the relevant annex. Procedures for activating and deactivating any selected LMTs and operational and administrative arrangements for using LMTs must be implemented by FMCs. National competent authorities (“**NCA**s”)

will be empowered under “certain circumstances” to require AIFMs to activate or deactivate a liquidity risk management tool.

### Costs and Charges

AIFMs will be required to report annually all direct and indirect fees and charges incurred by the AIF. In relation to “undue costs”, ESMA will be required to prepare a report within 18 months after the entry into force of AIFMD 2.0 assessing the level, reasons for and differences in the costs charged to retail investors and analysing whether the criteria set out in ESMA’s 2020 supervisory briefing on undue costs are to be complemented with regard to the notion of undue costs.

### Loan Origination Funds

AIFMD 2.0 will introduce a new loan origination funds (“**LOFs**”) regime, introducing a harmonised passport regime for LOFs. The key features of the new LOF regime are summarised in the table below.

#### Key Definitions

An LOF is defined as a fund which:

- (a) has an investment strategy which is mainly to originate loans; or
- (b) has originated loans the notional value of which represents at least 50% of its net asset value (“**NAV**”).

Loan origination is defined as being “*involved in structuring the loan, defining or pre-agreeing its characteristics prior to the purchase*”. By way of clarification, the final provisions note that loans originated by third parties and purchased by the AIF, in which the AIFM has no role in the structuring of the loan, are out of scope.

LOFs are closed-ended by default but the final text permits open-ended LOFs if it can be demonstrated that the IAF has liquidity management tools available that are consistent with its investment strategy and broader liquidity risk management system and redemption policy. ESMA will develop further requirements for an AIF to remain open-ended.

The final text specifies that loan origination can happen “indirectly” as well as “directly”. The recitals indicate that indirect loan origination activities via a third party or special purpose vehicle would fall within scope of the new loan origination regime.

<b>Risk Retention</b>	<p>The LOF is required to retain 5% of the notional value of each loan it originates and subsequently transfers to a third party:</p> <ul style="list-style-type: none"> <li>(a) until maturity for loans with a maturity of up to eight years, or for loans granted to consumers regardless of their maturity; and</li> <li>(b) for a period of at least eight years for other loans.</li> </ul> <p>Derogations from the risk retention rules are permitted where:</p> <ul style="list-style-type: none"> <li>■ the AIFM starts to sell assets of the AIF in order to redeem units or shares as part of the liquidation of the AIF;</li> <li>■ where the sale of the loan is necessary to enable the AIFM to implement its investment strategy, to comply with EU sanctions or with “product requirements”, or is due to a deterioration in the risk associated with the loan.</li> </ul>
<b>Leverage Limits</b>	<p>Open-ended funds: 175%</p> <p>Closed-ended funds: 300%</p> <p>Leverage will be calculated according to the commitment method and expressed as the difference between the fund’s exposure relative to the fund’s NAV. AIFMs will be permitted to rectify their positions should the fund unintentionally breach the cap for reasons beyond the AIFM’s control.</p>
<b>Loan Concentration Limits</b>	<p>The notional value of loans originated to any single borrower must not exceed in aggregate 20% of the AIF’s capital if the borrower is a financial undertaking, an AIF or a UCITS</p>
<b>Shareholder Loans</b>	<p>Shareholder loans will be exempt from the requirements if the loans’ notional value does not exceed in aggregate 150% of the AIF’s capital.</p>
<b>Transitional Arrangements</b>	<p>Existing AIFs originating loans will have five years from the date of entry into force of AIFMD 2.0 to comply with the new requirements with a possibility for AIFMs to opt in.</p>

## Level 2 Mandates

ESMA must prepare reporting templates in relation to the reporting of delegation arrangements.

The final text requires ESMA to prepare guidelines on the power of regulators to initiate or end the suspension of a fund and on fund naming conventions, within 24 months of the AIFMD 2.0 coming into force. This mandate allows ESMA to progress with finalising its proposed Guidelines on funds' names using ESG or sustainability-related terms published in November 2022. ESMA must also produce draft rules on liquidity management by open-ended AIFs that originate loans and on supervisory reporting content and processes within a year of AIFMD 2.0 coming into force.

## Next Steps

Delegation is one area addressed in AIFMD 2.0 where we may see further developments in advance of the application of the new reporting requirements. In a recent [speech](#), the Central Bank of Ireland (“**Central Bank**”) noted the important role that delegation has to play in the fund sector and stated that Ireland already has robust requirements in place to prevent the establishment and operation of “letter-box” entities and to ensure that firms are structured appropriately to effectively oversee their delegates. It was noted that the delegation reporting provisions contained in AIFMD 2.0 mark the start of a longer-term process that will take a more comprehensive look into delegation in Europe and the Central Bank has encouraged stakeholders to proactively engage at both national and European level on this work. We understand that the Central Bank will shortly issue a survey on delegation. This follows the announcement in ESMA’s 2023 work programme of the launch of a peer review on delegation and outsourcing.

AIFMD 2.0 will now be finalised and translated into the official languages of the EU. The European Parliament is expected to vote on AIFMD 2.0 in early February 2024 and the Council will then have to formally approve the final text. The final amending directive will then be published in the Official Journal of the EU. Member states will have 24 months from the date that AIFMD 2.0 comes into force to transpose the directive into national law, meaning that the new rules are likely to apply from 2026.



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