

Get Ready for AIFMD 2.0

April 2024

The directive amending the Alternative Investment Fund Managers Directive (“**AIFMD**”) has now been published in the Official Journal of the EU, clarifying the application dates of the revised requirements. The amending directive, known as AIFMD 2.0, must be transposed into the national law of member states by 16 April 2026.

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 national competent authorities (“**NCA**s”) 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.

The provisions amending the regulatory reporting requirements are due to apply from 16 April 2027. ESMA is tasked with preparing regulatory technical standards specifying the details of the information to be reported, the appropriate level of standardisation and the reporting frequency and timing.

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. NCAs 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.

Third-Party Management Companies and Conflicts of Interest

AIFMD 2.0 includes a new requirement that, where an FMC manages an AIF / UCITS at the initiative of a third-party, including cases where that AIF / UCITS uses the name of a third-party initiator or where an FMC appoints a third-party initiator as a delegate, the FMC must, taking account of any conflicts of interest, submit detailed explanations and evidence of compliance with the conflicts of interest provisions to its home state regulator.

ESMA is required to prepare a report on the requirements applicable to third-party FMCs and the need for any additional safeguards by April 2029.

Loan Origination Funds

AIFMD 2.0 introduces a new loan origination funds (“**LOFs**”) regime, introducing a harmonised passport regime for LOFs. Some of the new rules in AIFMD 2.0 will apply to all AIFs engaged in loan origination activity, while other requirements will only apply to AIFs that come within the definition of an LOF. The key features of the new 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 *“the granting of a loan directly by an AIF as the original lender or indirectly through a third party or special purpose vehicle, which originates a loan for or on behalf of the AIF, or for or on behalf of the AIFM in respect of the AIF, where the AIFM or AIF is involved in structuring the loan, or defining or pre-agreeing its characteristics, prior to gaining exposure to the loan.”*

This definition means that not all AIFs of EU AIFMs engaged in loan origination will meet the criteria of an LOF. This is an important distinction, as some of the new rules in AIFMD 2.0 will apply to all AIFs engaged in loan origination activity while other requirements will only apply to LOFs.

LOFs are closed-ended by default but the directive permits open-ended LOFs if it can be demonstrated that the AIF has LMTs 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.

AIFMD 2.0 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.

Risk Retention

An AIF that originates loans is required to retain 5% of the notional value of each loan it originates and subsequently transfers to a third party:

- (a) until maturity for loans with a maturity of up to eight years, or for loans granted to consumers regardless of their maturity; and
- (b) for a period of at least eight years for other loans.

Derogations from the risk retention rules are permitted where:

- the AIFM starts to sell assets of the AIF in order to redeem units or shares as part of the liquidation of the AIF;
- 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.

<p>Leverage Limits</p>	<p>The leverage of an LOF must not exceed the following limits:</p> <ul style="list-style-type: none"> ▪ Open-ended funds: 175% ▪ Closed-ended funds: 300% <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> <p>Borrowing arrangements fully covered by capital commitments from investors in the AIF will not be taken into consideration. The thresholds will not apply to an AIF whose lending activities consist solely of originating shareholder loans, provided that the notional value of those loans does not exceed in aggregate 150% of the AIF's capital. This derogation will not apply to real estate shareholder loans.</p>
<p>Loan Concentration Limits</p>	<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> <p>This limit will cease to apply once the AIFM starts to sell assets of the AIF in order to redeem units or shares as part of the liquidation of the AIF and will be temporarily suspended where the capital of the AIF is increased or decreased (such temporary suspension to last no longer than 12 months).</p>
<p>Transitional Arrangements</p>	<p>Existing AIFs originating loans will be deemed to comply with the concentration and leverage limits and liquidity management rules relating to open-ended AIFs until 16 April 2029, with a possibility for AIFMs to opt in.</p> <p>Until 16 April 2029, where the notional value of the loans originated by an AIF to a single borrower or the leverage of an AIF is:</p> <ul style="list-style-type: none"> (a) above the concentration limit (20%) or the leverage limit (175% or 300%), the AIFM must not increase that value or that leverage; or (b) below the concentration limit (20%) or the leverage limit (175% or 300%), the AIFMD must not increase the value or leverage above those limits.

Impact on Non-EU AIFMs

Only AIFMs authorised by a member state competent authority can manage and market AIFs in the EU using the management and marketing passports available under the AIFMD. Non-EU AIFMs may market within the EU using either national private placement regimes (“**NPPRs**”) or by relying on reverse solicitation. The terms of the AIFMD envisages the authorisation of non-EU AIFMs under the AIFMD at a future date; however the process by which the authorisation of non-EU AIFMs would be permitted has not been progressed since 2015.

When marketing in the EU under NPPRs, non-EU AIFMs must comply with a limited number of requirements under the AIFMD (relating to annual reports, disclosure to investors and regulatory reporting) and therefore the changes introduced under AIFMD 2.0 will not have a significant impact on non-EU AIFMs.

Amendments to the requirements relating to disclosure to investors will require non-EU AIFMs to provide descriptions of the possibility and conditions for using the selected LMTs and a list of fees, charges and expenses that the AIFM bears in connection with the operation of the AIF and that will be directly or indirectly allocated to the AIF. The AIFM must also disclose annual any parent company, subsidiary or special purpose vehicle used in relation to the AIF’s investments by or on behalf of the AIFM.

Additional regulatory reporting requirements will include providing information on the total amount of leverage which the AIF employs and information on delegation arrangements concerning portfolio management of risk management functions.

Under the first iteration of the AIFMD, there was a requirement that the third country in which the non-EU AIFM (or non-EU AIF) is established must not be listed by the Financial Action Task Force as a non-cooperative country or territory. This provision has now been amended to require that the third country must not be a high risk third country under the EU’s Anti-Money Laundering Directive. There are two new requirements providing that the third country must have signed an agreement with the member state where the AIF is to be marketed that complies fully with the OECD Model Tax Convention and it must not be on Annex I of the EU’s list of non-cooperative jurisdictions for tax purposes.

Level 2 Mandates

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

The directive 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 latter mandate allowed ESMA to progress with finalising its Guidelines on funds’ names using ESG or sustainability-related terms, published in May 2024. 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.

A Look Ahead

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 2023 [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. In late 2023, the Central Bank issued a survey on delegation. This followed the announcement in ESMA's 2023 work programme of the launch of a peer review on delegation and outsourcing.

Please get in touch with your usual Asset Management and Investment Funds Department contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this briefing note.

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