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European Commission Report on the Operation of the AIFMD

Report concludes that the AIFMD has been helpful in building a market for AIFs, but is not free from issues.

Key Points:

- The report concludes that the AIFMD has played a significant role in helping to create an internal market for AIFs.
- However, the report also finds inconsistencies in how Member States apply the AIFMD.
- The report recommends that a number of areas need further harmonisation to prevent rule arbitrage.

The Alternative Investment Fund Managers Directive (AIFMD) was adopted in 2011 in response to the financial crisis, and sought to extend regulation and oversight to all actors in the sector embedding significant risks. The AIFMD therefore introduced a harmonised framework for managers of alternative investment funds (AIFs).

The AIFMD requires the European Commission (Commission) to review the operation of the AIFMD. The Commission has embarked on the first stage of this review by carrying out a survey among stakeholders, and has published its Final Report on the findings from the survey. The Commission considered 748 responses, the majority of which were submitted by alternative investment fund managers (AIFMs) and investment managers of AIFs. The report presents mixed results.

Overview of the Final Report Findings

Definitions of AIFMs and AIFs

The survey asked respondents for their thoughts on the definitions of AIFMs and AIFs. Many said that the definitions are unclear and that the scope of the exemptions in Article 3 of the AIFMD are uncertain. For instance, respondents said that:

- There are different definitions of what is an AIF
- The criteria to define an AIF differs between Member States, in particular with regard to the number of investors that is relevant in relation to capital raising

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- There are differences with regard to the interpretation of the formation of investment vehicles and AIF structures, in particular whether each sub-fund is an AIF

The survey found that unclear definitions make it hard to assess the scope of the AIFMD, with the consequence that non-fund vehicles sometimes are brought in scope of the rules.

Marketing

One third of the respondents to the survey said that the AIFMD is applied inconsistently among Member States. Most of the concerns relate to the marketing requirements, and uncertainty over the application of the concepts of marketing and pre-marketing. For instance, respondents noted that the German regulator has a stricter view of the pre-marketing phase than national competent authorities (NCAs) in other Member States. The differences in the activities that constitute marketing were said to undermine the efforts of enhancing the Single Market, as in some Member States it is possible to undertake a much broader range of activities before the marketing requirements begin to apply.

As a consequence of the inconsistent application of the marketing rules, and the approach to marketing across Member States, there is a lack of transparency of the rules in place. The lack of transparency makes it difficult for firms to roll out uniform marketing policies, procedures, and activities across the EU, which in turn undermines the marketing passport. The report found that firms are therefore required to spend more time and money to market AIFs across Europe.

Moreover, survey respondents criticised the Commission’s proposal regarding cross-border distribution of funds, which was adopted in March 2018 as part of the Capital Markets Union initiative, for being insufficient. The Commission’s proposal seeks to address, amongst other things, the uncertainty around the definition of pre-marketing, which respondents criticised for being focused on the retail market space and therefore not suited for the professional market space.

Non-EU Passports and National Private Placement Regimes

In relation to the discussions concerning the inconsistent application of the marketing passport, some respondents called for an introduction of non-EU passports. In relation to this discussion, national private placement regimes were said to add value for non-EU AIFs and AIFMs, and most respondents said they want to keep the national private placement regimes, even if non-EU passports are introduced.

Disclosure to Investors

Respondents said that the rules on investor disclosure ensure that investors are sufficiently informed to make investment decisions. However, they acknowledged that Member States have gold-plated the disclosure requirements and that the consequent additional disclosure requirements above those required by the AIFMD do not help investors to select information relevant for their needs.

Respondents mentioned that professional investors often have specific requirements on the information they want to receive, so it was suggested that professional investors should be able to opt-out of the disclosure requirements.

Further, respondents commented on a few issues, in particular around duplication of information in relation to closed-ended funds that also are subject to the requirements of the Prospectus Directive, and insufficient standardisation of requirements concerning fee disclosures. Respondents also highlighted that further alignment with the disclosure rules in MiFID II is needed in terms of calculation of fund performance.

Investments in Non-Listed Companies by PE Firms and Venture Capital Firms

Survey respondents particularly criticised the notification requirements regarding investments in non-listed companies. They said that the notifications required to be made to NCAs are not useful and that the information provided by the AIFM to the controlled company does not positively impact the relationship between the AIFM and the controlled company.

Many respondents also said that notification and asset stripping rules do not apply in their countries for non-AIFMs. However, the respondents acknowledged that the AIFMD rules do not discourage them from making investments in non-listed companies through AIFs.

Reporting to NCAs

Due to different interpretations of applicable rules or additional reporting requirements, survey respondents said that the requirements for reporting to NCAs differ among Member States. Moreover, they said the amount of data required for reporting is disproportionately high since, for example, it includes data that cannot be processed quarterly. Moreover, respondents identified redundancy and duplication of reported data as an issue. The issues around reporting were said to entail higher costs for firms.

Respondents asked for a comprehensive review of the reporting requirements applicable to asset managers before any changes are made to the reporting requirements, to avoid any unnecessary costly changes to reporting systems. The respondents asked for regular provision of market analysis by ESMA and NCAs as compensation for the regulatory burden.

Supervision and Sanctions

Interestingly, only 22% of survey participants had been subject to an on-site inspection by an NCA. The frequency of on-site inspection was said to depend on the size of the AIFM.

The NCAs responded that the most used sanctions were the imposition of a temporary prohibition (40%), withdrawing authorization (40%), criminal prosecution (20%), cessation of contrary practices (20%), and redemption of units (9%).

Impact of and Interplay with Other EU Legislation

Respondents said the following all impact the AIFMD:

- MiFID II
- The Undertakings for Collective Investments in Transferable Securities (UCITS) Directive
- Packaged Retail and Insurance-based Investment Products Key Information Document (PRIIPs KID)
- European Market Infrastructure Regulation (EMIR)
- The Securities Financing Transaction Regulation (SFTR)
- The Prospectus Directive and Central Securities Depositaries Regulation (CSDR)

The reported impacts were both positive and negative, as summarised below.

Negative Impacts on the AIFMD:

- MIFID II:
  - The professional investor definition creates problems for certain investors, such as pension schemes, foundations and charities
  - The scope of AIFMD vs MiFID II is unclear in terms of their application, references to the capital requirements regime, and differences in prudential treatment
  - ESMA's classification of all AIFs as complex products is challenging under the product governance rules as the classification makes AIFs less attractive for retail distribution markets
- EMIR and STFR: the classification of investment funds and the operational and reporting requirements burdens AIFMs.
- Prospectus Directive: there is a duplication of information standards for investors under AIFMD and the prospectus regime, which affects publically-offered closed-ended AIFs
- PRIIPs KID: past performance data for PRIIPs is difficult to compare with different types of AIFs

Positive Impacts on the AIFMD:

- UCITS: there are standardised operational requirements for managers that operate both types of funds and similarities between AIFMD and UCITS where the AIFs are invested in similar assets to UCITS.
- CSDR: AIFMD exempts CSDs from its scope, which allows efficient functioning of the CSD-dedicated regulatory framework.

Next Steps

The Commission is obliged to carry out a review of the application and scope of the AIFMD under Article 69 of the AIFMD. The Commission's Final Report on the findings from the survey is the first step of this review. The survey sought to identify areas where further reflection is needed and it is clear to us that there is room for consideration and improvement. The next step is for the Commission to issue a report on the functioning of the AIFMD to the European Parliament and the Council in which the Commission may propose appropriate amendments to the AIFMD. The report will be issued during 2020.

Firms in scope of the AIFMD should familiarise themselves with the findings in the Final Report. We expect the Commission to propose amendments to the AIFMD to address the areas of concern that were brought to light through the survey.

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