Modification of the European regime for harmonised collective investment schemes and alternative investment fund managers

The forthcoming directive extensively modifies the delegation regime, liquidity risk management and supervisory reporting for managers of collective investment schemes (IIC) and alternative investment funds (AIFs), as well as loan origination by alternative investment funds.

REYES PALÁ LAGUNA
Professor of Corporate & Commercial Law, University of Zaragoza
Academic Counsel, Gómez-Acebo & Pombo

1. Introduction

On 7 February last, the European Parliament adopted its first reading position on the Proposal for a Directive of the European Parliament and of the Council amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services and loan origination by alternative investment funds. This text was approved by the Council on 24 February and awaits publication in the Official Journal of the European Union.

It is a wide-ranging amendment of both Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD) and Directive 2009/65/EC on undertakings for collective investment in transferable securities (UCITS Directive). In doing so, the Commission is moving forward with the implementation of the four proposals set out in its November 2021 Communication "Capital Markets Union - Delivering one year after the Action Plan". The creation of a European single access point providing centralised access to publicly available information of relevance to financial services, capital markets and sustainability (Regulation 2023/2859 of 13 December) and the reform of the European long-term investment funds regime (Regulation 2023/606) have also been approved; the amendment of the Markets in Financial Instruments Regulation (MiFIR) for the

establishment of the consolidated tape has yet to be published in the Official Journal.

The amendments to the two directives go in the same direction, since AIFs are undertakings for collective investment - like traditional or harmonised collective investment schemes - that are defined by exclusion in the 2011 directive in the sense that this directive regulates the managers of undertakings for collective investment that do not require authorisation under the UCITS Directive; they are thus classified as alternative funds. In Spanish law, these undertakings are private equity entities (firms and funds) and other closed-end collective investment entities, which are the entities covered by Act 22/2014 of 12 November 2014. The third recital of the proposal states that the AIF market reached EUR 6.8 trillion in net asset value by the end of 2022.

The amendment puts certain obligations of UCITS and AIF managers on an equal footing

Traditionally, AIFs - hedge funds, private equity - were not marketed to retail investors: private equity was exclusively addressed to professional clients. However, Act 22/2014 already allowed the shares or units of these entities and those of other closed-end entities to be marketed to other investors, with a minimum investment of one hundred thousand euros, provided that the retail investors stated in writing that they were aware of the risks associated with their investment. In 2022, the rule is amended to allow investments by retail investors based on "a personalised recommendation from an intermediary who provides them with advisory services, provided that, in the event that their financial assets do not exceed 500,000 euros, the investment is at least 10,000 euros, and is kept, and does not represent more than 10% of said assets" (Art. 75(2)b of Act 22/2014).

At the same time, this Private Equity Act amends the Collective Investment Schemes Act to include in a new Article 33 bis so-called "free investment schemes", i.e. collective investment firms and funds not harmonised by the UCITS Directive. It was not until December 2023 that the Collective Investment Schemes Regulations were amended to allow the marketing of these free investment schemes to retail investors under the same terms as those established for private equity entities, i.e. with the aforementioned investment thresholds of less than 100,000 euros under the aforementioned conditions.

We said that the amendments to both directives go in the same direction and it will be necessary to amend both Act 22/2014 and the Collective Investment Schemes Act (together with the implementing regulations thereof) to incorporate the changes into Spanish law not only in the matters referred to in the title of the proposed directive (delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services and loan origination by alternative investment funds), but also as regards the integration of environmental, social and governance (ESG) criteria in the governance and risk management rules used by managers of collective investment schemes and of alternative investment funds when making investment decisions. The amendment to the two directives details the information to be provided by managers for the purposes of compliance with Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

The proposed directive consists of four articles: the first article amends the AIFMD; the second

article amends the UCITS Directive; the third and fourth articles deal respectively with the transposition of the amendments into the national law of the Member States and its entry into force. The deadline for transposition is set at 24 months from its entry into force (20 days after publication in the Official Journal of the European Union). Several of its articles require further implementation through European Securities and Markets Authority guidelines, for example, in cases where the name of a collective investment scheme or alternative investment fund is unfair, unclear or misleading.

The following is a non-exhaustive overview of some of the amendments.

2. Extension of the services that managers can provide

Managers of harmonised collective investment schemes will be able to provide - if so provided for in national law - the administration of benchmarks in accordance with Regulation 2016/1011 (excluding this service in respect of the managed undertaking) and, as a new ancillary service, the reception and transmission of orders in relation to one or more financial instruments, in line with this possibility already allowed for AIF managers (AIFMs). Similarly, the administration of benchmarks is expressly recognised as a possible activity for AIFMs. In addition, credit servicing activities in accordance with Directive 2021/2167 are added for the latter.

3. Loan origination by AIFs

It should be recalled that the 2011 Directive regulates AIFMs irrespective of the legal form of the funds managed and irrespective of whether they are open-ended (free investment schemes) or closed-ended (closed-end collective investment schemes). Therefore, when regulating loan origination by hedge funds or private equity, the forthcoming proposal for a directive allows Member States to establish a more restrictive regime for certain alternative investment funds. The aim is to "establish an efficient internal market for loan origination by AIFs, to ensure a uniform level of investor protection in the Union, to make it possible for AIFs to develop their activities by originating loans in all Member States and to facilitate access to finance by Union companies". The rules applicable to AIFMs that grant loans, either directly or indirectly through a third party or through the creation of a special purpose vehicle, are therefore harmonised. Managers must have effective policies and procedures in place for loan origination, credit risk assessments and loan portfolio administration and monitoring. Where the borrower is a financial institution, they must diversify risk and subject their exposure to specific limits detailed in the proposal. A limit on leverage is introduced which varies according to the open or closed nature of the entity or fund under management. The rule allows national law to prohibit lending to consumers by these alternative funds.

The regime for loan origination by AIFs is described in detail

In order to limit conflicts of interest, AIFMs and their staff should not receive loans from any AIFs that they manage. Similarly, the AIF's depositary and the depositary's delegate, the AIFM's delegate and its staff, and entities within the same group as the AIFM, should be prohibited from receiving loans from the AIF concerned. Furthermore, the origination of loans with the sole purpose of selling them to third parties ("originate-to-distribute strategy") is prohibited - albeit with exceptions - and the

obligation for fund managers to report to their investors on the composition of the originated loan portfolio is expressly laid down.

4. Liquidity management tools and investment redemption

In order to be able to meet investors' redemption requests, managers must include in the instruments of incorporation of the open-ended fund at least two liquidity management tools from the list set out in Annex V to Directive 2011/61/EU. By way of derogation, if the fund has the status of a money market fund, the selection of only one liquidity management tool from this list is permitted. A similar provision is made for harmonised IIC managers, referring in this case to Annex II to the UCITS Directive for the selection of liquidity management tools.

The possibility for both types of managers to temporarily suspend subscriptions, repurchases and redemptions or to activate separate portfolios of illiquid assets in exceptional circumstances where justified in the interests of investors is maintained. In this respect, redemption in kind is not permitted for retail investors.

5. Arrangements for the distribution and marketing of shares and units of undertakings for collective investment and alternative investment funds

The marketing of schemes and funds is not always conducted by the manager directly but by one or several distributors either on behalf of the manager or on their own behalf. In particular, there could be cases where an independent financial advisor markets a schemes and shares without the manager's knowledge. These distributors are subject either to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (MiFID II) or Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (IDD).

The UCITS Directive and the AIFMD are amended to reflect the diversity of distribution arrangements, so that when the distributor acts on behalf of the manager, this activity is considered a delegation arrangement. Where the distributor acts on its own behalf, the applicable delegation regime is no longer that of the UCITS Directive or Directive 2011/61/EU "irrespective of any distribution agreement between the management company and the distributor", but that of MiFID II or IDD.

6. Equalisation of the delegation regime, asset safekeeping and supervisory reporting requirements

The amendment, provided that there are no reasons justifying a different treatment, brings the regime of IIC managers in line with that of AIFMs in the matters indicated.

In addition, both directives are amended to add as a requirement for obtaining administrative authorisation to carry on their activity the appointment of at least two natural persons of sufficiently good repute and sufficiently experienced who either are employed full-time by the management company or are executive members or members of the governing body of the management company committed full-time to conducting the business of that management company, and who are domiciled in the Union.

7. Fee regime

With regard to the fees that AIFMs receive, either from their clients or from their managed

entities, they will have to detail them in the information to be made available to potential investors in accordance with the new wording of Article 23 of Directive 2011/65/EU. They must indicate which are borne by the manager and subsequently allocated directly or indirectly to the fund or to any of its investments. They must report annually on all direct and indirect fees, charges and expenses borne directly or indirectly by investors.