
2.2 WHITE PAPER

Disclosure and transparency under AIFMD: a new standard



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Introduction

The Alternative Investment Fund Manager Directive ('AIFMD')¹ and the Commission Delegated Regulation (EU) No 231/2013 ('the Delegated Regulation')² introduces new rules for Alternative Investment Funds ('AIFs') (including hedge funds, private equity and real estate funds). This should bring about change in a scenario where previously these structures were not regulated through pan-European initiatives, but were largely subject to national regimes and codes of conduct issued by industry associations.

As two facets of the same coin, provisions on disclosure and transparency focus on a new minimum standard of information with the aim of ensuring enhanced investor protection as part of the G20 response to the financial crisis. This commentary examines these provisions and makes some key considerations regarding their impact from a regulatory perspective.

Investor transparency

Article 23 of the AIFMD sets the stage for investor transparency requirements by requiring pre-investment³ and ongoing⁴ disclosures to be provided to investors and potential investors.

In terms of this article, all EU AIFMs and non-EU AIFMs must make available to investors, prior to committing to invest, key information regarding the fund, including details on the investment strategy, periodic disclosure of the percentage of the fund's assets that are subject to special arrangements due to their illiquidity (e.g. gates or side pockets), any new liquidity management arrangements, valuation procedures, the latest net asset value and regular disclosures of the level of fund leverage. Any material change to this information must also be made available prior to investment.

The AIFMD does not specify the manner in which this information ought to be provided. Although not mandatory it is customary to include this information in the offering

document or prospectus. In fact, where the information is likely to change (e.g. in the case of the net asset value figures) it is mostly provided elsewhere such as in a factsheet or in another document provided to the prospective investor prior to the execution of the subscription.

In terms of information to be regularly provided to investors following their investment, Articles 23(4) and 23(5) of the AIFMD supplemented by Articles 108 and 109 of the Delegated Regulation set out periodic and regular disclosure.

AIFMs are required to periodically disclose the following information to investors:

- the percentage of assets that are subject to special arrangements arising from their illiquid nature;
- any new liquidity management arrangements;
- the current risk management profile of the AIF; and
- the corresponding risk management systems of the AIFM.

On the other hand, regular disclosure is required in relation to the total amount of leverage employed by the AIF together with any changes to:

- the maximum level of leverage which the AIFM may employ on behalf of the AIF;
- any right to the reuse of collateral; or
- any guarantee granted under a leveraging arrangement.

The "periodic" and "regular" information is wide in scope and there seems to be no clear distinguishing factor between the two. The AIFMD does not provide much guidance on the frequency with which this information is to be provided to investors. Some of the periodic and regular disclosure is to be made available "as required by the AIF's rules or instruments of incorporation", or "at the same time as the offering memorandum and at a minimum at the same time as the annual report is made available". On the other hand certain

1. Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 [2011] OJ L174/1

2. Commission Delegated Regulation (EU) No 231/2013 of 19 December 2013 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision

3. AIFMD Art. 23(1)

4. AIFMD Art.23(4) and Art. 23(5)

periodic disclosure is to be made available “immediately” while certain regular reporting is to be made available “without undue delay”.

There is a degree of flexibility on the medium used to provide this information to investors. This includes letters to investors, newsletters, use of websites and emails as well as supplements to the offering document. It is up to the AIFM to determine the appropriate mode of communicating the relevant information in a timeframe compliant with the AIFMD requirements, and using a method which is most appropriate to the needs of the investors.

Regulator transparency

Articles 22 and 24 of the AIFMD provide for the disclosures to be made to the national competent authorities of the AIFM.

The most straightforward requirement is the preparation of an annual report made available to existing (and prospective) investors within 6 months of the end of the financial year. This annual report must follow the requirements prescribed in Article 22 of the AIFMD and include disclosure on the amount and type of remuneration for certain categories of staff. This report must be made available by the AIFM for each EU AIF it manages and for each AIF it markets into the EEA. Additional disclosure in the annual report applies where the AIF acquires control of a unlisted company.⁵ The AIFM is also required to provide a detailed list of all AIFs it manages. Moreover, the AIFMD requires a comprehensive set of systemic risk reporting covering both the AIFM and the AIF it manages or markets. The risk reporting includes:

- the breakdown of investment strategies of AIFs
- the principal markets/ instruments in which an AIF trades;
- total value of assets under management of each AIF managed;
- turnover of the AIFs; and
- principal exposures and most important portfolio concentration of the AIFs

Additional information on leverage is also required for AIFMs employing leverage on a substantial basis⁶.

Implications for AIFMs and regulators

In a sector that historically has been either subjected to a light regulatory regime or no regulation, various industry players and commentators take the view that transparency requirements are too onerous and have been drafted without taking into consideration the exigencies of particular types of

AIFs. Another argument put forward is that typical professional investors in AIFs do not require such a high level of protection. Without going into the merits of these arguments, it is clear that the AIFMD has created a minimum set of uniform standards which are aimed at bolstering investor protection and ensure investors receive regular and comprehensive information on the AIF they invest in. Moreover, it provides regulators with a wealth of information that can be analysed and evaluated so that timely action can be taken to mitigate systemic risk.

Standards have certainly been raised for the fund managers that are in scope of reporting obligations. Fund managers of a modest size and slim back-office operation/ support have had to adjust their business models and either invest in new reporting systems or otherwise outsource the regulatory reporting obligations to third parties.

From a regulatory viewpoint, regulators are being faced with a number of queries notably relating to AIFMs’ reporting obligations under the AIFMD. The obligations are far reaching and a number of regulators (including ESMA) have issued Q&A documents with a view to providing further clarity. Regulators are also investing in technology with a view to enhancing their ability to process this information in an effective and efficient manner.

During the past year, the Malta Financial Services Authority (‘MFSA’) has been preparing for the significant change in the regulatory environment brought about by AIFMD. The Authority has set up an AIFMD reporting project management team with responsibilities for the delivery of the AIFMD systemic reporting solution. This team is in the final stages of implementing an IT platform which aims to facilitate centralisation of reported data and ensure that the Authority has flexible systems to maximise the use of this data for prudential supervision purposes.

As AIFMD reporting is progressively coming on full steam it is of the utmost importance that the AIFMs who are not adequately prepared, increase their efforts to meet these challenges. Reporting entities should be aware that the data required for reporting may not be in their possession already and hence they may need to source it from third parties.

In conclusion, any AIFM that has not yet assessed the impact of new reporting and transparency requirements on their organisation should start considering the changes that the new regulatory regime will bring about. AIFMs should also devise and implement the necessary changes on a technical, operational and resourcing level in order to be able to meet regulatory requirements in a timely manner.

5. AIFMD Article 29

6. AIFMD Article 24(4)