MFSA MALTA FINANCIAL SERVICES AUTHORITY

Circular

19 April 2024

Publication of the AIFMD II

1.0 Introduction

On 26 March 2024 Directive 2024/927/EU ('the Directive') was published in the EU's Official Journal and entered into force on 15 April 2024. The Directive makes amendments to the AIFMD (Directive 2011/61/EU) and, to a relevant extent, the UCITSD (Directive 2009/65/EU).

This legislative update brings forth several changes that warrant attention from stakeholders in the financial services industry, particularly funds, fund managers, depositaries, and fund administrators.

2.0 Main Elements and Implications for AIFMs

The Authority had already communicated the progress on this legislative file in its Circular of 21 December 2023.

The industry's attention is now drawn to the finalised key changes regarding delegation, liquidity risk management, supervisory reporting, the provision of depositary and custody services, and loan origination by AIFs introduced by the Directive.

The amendments will apply to above threshold EU AIFMs. They will not affect sub-threshold (deminimis) EU AIFMs nor non-EU AIFMs, unless those AIFMs market AIFs in the EU under the National Private Placement Regime ('NPPR') or act as delegates of EU AIFMs.

2.1 Conditions for AIFM Activities

The AIFM's authorisation process is being strengthened by requiring applicants to provide more details about the personnel effectively running the AIFM. Specifically, detailed information on roles, responsibilities, resource allocation, and reporting lines will now be required.

The changes allow AIFMs to offer two additional activities as non-core services: administration of benchmarks and credit servicing. However, AIFMs cannot administer benchmarks applied within the AIFs they manage.

The Directive also expands the functions AIFMs can perform to include loan origination and servicing of securitisation special purpose entities in addition to portfolio management and risk management.

2.2 Substance and Delegation

In terms of substance the Directive puts as a condition for granting authorisation, the need for a minimum of two individuals in full-time employment and domiciled in the Union who decide on the conduct of the business.

Delegation arrangements are retained and updated to permit AIFMs to delegate core functions listed in Annex I or any non-core functions to third parties. However, AIFMs must ensure that the delegated functions or services comply with AIFMD provisions, regardless of the delegate's regulatory status or jurisdiction. The AIFM remains fully responsible for the proper performance of the delegated tasks.

2.3 Loan Origination

The introduction of loan origination activities as part of the investment strategies available to AIFMs stands out as a significant change resulting from the AIFMD review. The regime differs depending on whether the AIFs merely originate loans or whether the AIFs originate loans on a significant basis (‘loan originating AIFs’). Most of the loan origination provisions will apply to all AIFs when originating loans, with some additional provisions applying specifically to loan originating AIFs.

This strategy necessitates adequate risk management, liquidity management, and disclosure obligations and requirements. These are prescribed in the Directive.

The Directive also introduces specific investment restrictions, including:

- Limits on the notional value of loans to any single borrower, capped at 20% of the AIF's capital if the borrower is a financial undertaking, AIF, or UCITS.

- Leverage restrictions, with open-ended AIFs limited to 175% and closed-ended AIFs to 300%.

AIFMs must ensure that loan-originating AIFs do not extend loans to the AIFM or its staff, the AIF's depositary, delegated entities, or entities within the same group. Additionally, AIFMs must ensure that the AIF retains 5% of the notional value of each loan originated and transferred to third parties.

Existing loan funds, will be subject to transitional provisions essentially granting AIFMs managing such funds a 5-year period to comply with the new requirements. Three scenarios are contemplated in the context of these transitional arrangements and requirements vary according to the scenario.

2.4 Liquidity Management Tools

The Directive introduces a framework to enable AIFMs to manage liquidity and market stress issues in a coherent system that guarantees investor protection. The existing liquidity management provisions in AIFMD have been extended, with new obligations and powers for AIFMs that manage open-ended AIFs. One notable change for AIFMs that manage open-ended AIFs is the requirement to select at least two additional liquidity management tools from a specified list after taking into consideration the investment strategy, the liquidity profile, and the redemption policy of the AIF. These tools shall be included in the AIF Rules or the instruments of incorporation.

2.5 Depositary Provisions

The revised text introduces an important change concerning the appointment of the depositary and the requirement for it to be domiciled in the AIF's Member State. The home Member State of the AIF can allow institutions established in another Member State to act as depositary for the AIF subject to a number of conditions, namely:

- a reasoned request from the AIFM demonstrating the lack of depositary services in the AIF's home Member State that can effectively meet the AIF's needs considering its investment strategy; and
- the total value of assets entrusted for safekeeping in the national depositary market of the AIF's home Member State, managed by EU AIFMs, should not exceed €50 billion.

Competent authorities will evaluate requests on a case-by-case basis.

The Directive clarifies expectations regarding the treatment of CSDs within the custody chain. The necessity for depositaries to conduct ex-ante due diligence checks when the custodian is categorized as a CSD is being removed. Regarding the delegation of depositary custody functions, services rendered by a CSD operating as an issuer CSD are not construed as delegation, whereas those provided by a CSD functioning as an investor CSD are deemed as such.

2.6 Disclosure Obligations and AIFMD Reporting

Disclosure requirements have been strengthened, particularly concerning:

- liquidity risk management and liquidity management tools used for loan origination AIFs;
- fees, charges, and expenses incurred by the AIFM directly or indirectly;
- loan origination portfolio, including fees borne by investors; and
- special purpose vehicles used in AIF investments by or on behalf of the AIFM.

Reporting to the competent authority in terms of Annex IV reporting shall now include:

- details on traded instruments, membership in markets, exposures, and assets of each AIF, with necessary identifiers for data connection;
- information on total leverage employed by the AIF;
- prescribed details on delegation arrangements for portfolio or risk management; and
- the list of Member States where AIF units or shares are marketed by the AIFM or its distributors.

2.7 Third Countries

Throughout the provisions of the revised text, any references to the FATF non-cooperative country and territory list have been replaced by the EU list of non-cooperative jurisdictions for tax purposes.

3.0 Main Elements and Implications for UCITS ManCos

The Directive makes various changes to the UCITS Directive to bring it closer to the AIFMD in key areas. This is the case for the substance and delegation requirements, including the need for an objective reason for delegation, the depositary provisions, the supervisory reporting requirements, the availability and use of liquidity management tools and ESG integration.
In addition, there are a few amendments that specifically target UCITS. In particular, UCITS are not permitted to engage in loan origination while for MMFs a single liquidity management tool may be selected.

4.0 Level II/III Measures and Other Mandates for ESMA

The newly published legislation delegates certain areas to ESMA for more detailed rulemaking that will complement the Directive. The main areas consist of:

- RTS to establish criteria for on liquidity management by open-ended AIFs that originate loans;
- RTS and ITS to standardize the supervisory reporting process by AIFMs/UCITS;
- RTS to specify the characteristics of the liquidity management tools;
- Guidelines on the selection and calibration of liquidity management tools by AIFMs/UCITS ManCos;
- Guidelines to specify situations where the name of an AIF or UCITS could be unfair, unclear or misleading to the investor; and
- Updated guidelines on sound remuneration policies to align incentives with ESG risks in remuneration policies.

ESMA is also tasked to produce reports:

- for the EU's authorities reviewing the data on AIF costs and charges with a view to scrutinising costs imposed on investors (by 16 October 2025).
- on delegation arrangements, the loan origination regime and the impact of liquidity risk management tools on financial stability (by 16 April 2029)

5.0 Transposition, Implementation and Transitional Measures

Member States have to transpose and implement the Directive into national law by 16 April 2026, subject to certain transitional measures which require application from 16 April 2027. The industry will be kept updated on the relevant legislative changes to implement the revised AIFMD and UCITS, as well as their implementation.

Market participants are invited to assess in advance the changes which may impact their business and to prepare for the adaptations required prior to the application date.

5.0 Conclusion

Should you have any questions on the contents of this circular, please contact the Investment Services Supervision Function on isspolicy@mfsa.mt.