Domiciliation, hosting and ManCos

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AIFMD II – Will extensions continue forever, or are we nearing the edge of the cliff?

It has been talked about for the last three years. There have been independent reports and surveys and a date set, several years ago.

> However, years on from the start of the debate, nothing has actually happened. But that doesn't mean it won't.

And whilst the ability to treat the EU as one market is a key topic in the discussion, we are not, for once, talking about Brexit. We're talking about Alternative Investment Fund Managers Directive ("AIFMD" II), the sequel we have all been waiting for.

In July 2017 the Directive went under review. The European Commission ("EC") was looking for industry experts to examine whether AIFMD's initial objectives had been met and to observe the impact it had on the alternatives industry. KPMG published a 427-page report [1] to "provide and assess evidence for the EC's review of AIFMD".

AIFMD was conceived to standardise the regulations around the Alternative Investment Fund Management industry, throughout the EU. However, the report suggests that EU regulators have taken a disjointed approach to implementation. Particularly, there are two main concerns with the EU Marketing Passport: the different marketing requirements that exist between members states, and uncertainty over defining "marketing" and "pre-marketing". Additionally, Fund Managers have found it difficult to utilise the passport due to different approaches from various national regulators.

But that's not all...

Another key issue was the use of leverage within Alternative Investment Funds ("AIF"s), caught by the Directive. This is rooted in the variety of different calculation methodologies used. Similar issues were encountered in reporting requirements, owing to the lack of cohesion between separate regulatory obligations, specifically between the reporting requirements for AIFMD, and those of other regulatory regimes that are applicable to AIFs in the EU. Respondents to the review also noted that the regular publication of aggregate figures would assist in providing industry members with a greater feel for the market.

Despite the obvious issues, AIFMD has delivered in some key areas. Management passporting has been a relative success and jurisdictions such as Luxembourg, Ireland and the UK have benefited by allowing funds established in one EU jurisdiction to be managed in another. Despite the lack of harmonisation between AIFMD and other EU regulation, the Directive has been successful in creating an internal market for AIFs, and a structured regulatory environment for Alternative Investment Fund Managers ("AIFM"s). Respondents to the KPMG review were relatively unsatisfied with the consistency of implementation across the EU states, but there still seems to be positive signs around a single market for AIFs and the Capital Markets Union.

So, what could be improved?

An overriding issue is the detachment between AIFMD and existing EU regulation. By ensuring data reporting is necessary, efficient and not duplicated from other regulation, the EC can reduce the excessive time spent collating this data. Additionally, the EC should reduce the disconnection between national regulators within the EU when it comes to the proposed Directive. The EC must prioritise enhancing the togetherness felt between individual member states, in order to ensure AIFMs are fully aware and compliant within certain jurisdictions.

Does this mean that AIFMD II is happening? Sort of...

The EC has already agreed wording for AIFMD II around "pre-marketing". This should serve to address the largest issue with AIFMD and is due to be implemented by all member states by August 2021. However, other than this, very little has been agreed or released.

However, there is more that could be done.

One item that we, at MJ Hudson, would like to see addressed is the feedback from regulatory reporting obligations. As the Packaged Retail and Insurance-based Investment Products regime ("PRIIPS") is implemented and the requirement for Key

Information Documents ("KID"s) to be provided to investors across the private equity, real estate and VC markets takes force, we have noticed that the benchmarking provisions in these reports are extremely difficult to compute. The KIDs add little or no value to investors as a comparable across various products. Alongside this, EU regulators are being fed vast amounts of data on all AIFs within all market sectors under the Annex 4 requirements. In theory, between the EU member states, they have the largest repository of performance and investor information around and yet they do not seem to be creating any value from it. It is there to enable the EU to monitor all their (and investors') risk exposures at any given time.

Could AIFMD II force regulators to collaborate and share certain data points to enable investors to better benchmark and compare fund strategies across the industry? Our view is that they almost certainly could, but almost certainly won't. We can hope.

1 "Report on the Operation of the Alternative Investment Fund Managers Directive (AIFMD)", KPMG, December 2018

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