

# REGULATION OF INVESTMENT FUNDS

Proposal COM(2021) 721 of 25 November 2021 for a Directive amending Directives 2011/61/EU [AIFM Directive] and 2009/65/EC [UCITS Directive].

## cepPolicyBrief No 7/2022

**SHORT VERSION** [[Go to Long Version \(only in German\)](#)]

### Context | Objective | Interested Parties

**Context:** As a reaction to the financial crisis, rules for the regulation of investment funds were established by way of the Directive on Alternative Investment Fund Managers (AIFM Directive, see [cepPolicyBrief](#)) and the Directive on Undertakings for Collective Investment in Transferable Securities (UCITS Directive, see [cepPolicyBrief](#)). With targeted adjustments of the Directives, provisions on loan-originating funds, liquidity management, custody services, delegation arrangements, investor protection and reporting obligations, among others, are now to be established or amended.

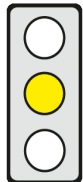
**Objective:** The Commission wants to further strengthen the internal market for investment funds, ensure a high level of investor protection and mitigate financial stability risks.

**Interested parties:** Investment funds and their managers, other financial market actors, investors.

### Brief Assessment

#### Pro

- ▶ EU rules on lending by AIFMs strengthen the single market and investor protection. Restrictions on lending by loan-originating funds to individual financial undertakings may limit interconnectedness and the resulting financial stability risks.
- ▶ The fact that AIFMs or UCITS management companies can draw on eight different LMTs across the EU strengthens investor protection and the stability of financial markets.
- ▶ Allowing AIFMs in small markets to use depositaries in other EU countries prevents them from having to use inefficient domestic depositaries. This is a first step towards deepening the single market.

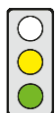


#### Contra

- ▶ The fact that loan-originating funds must be closed-end funds if the notional value of loans granted exceeds 60% of the net asset value of the AIF creates legal uncertainties.
- ▶ The proposal to strengthen transparency on delegation arrangements lacks legal clarity and certainty.
- ▶ Further disclosures on fees and charges are unnecessary. Quarterly disclosures are often inaccurate and costly to collect. Investor protection is not served by this.

### Loan-originating funds

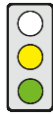
**Commission proposal:** Loan origination is recognised as a legitimate activity of AIFMs. AIFMs must have "effective policies, procedures and processes" in place for loan origination by an AIF which they manage. Originating loans to borrowers from the financial sector will be restricted. AIFs must retain 5% of the notional value of the loans they originate and subsequently sell on the secondary market. AIFs must be closed-end funds if the notional value of the loans extended exceeds 60% of the net asset value of the AIF.



**cep-Assessment:** The implementation of policies, procedures and processes for loan origination promotes sound management of the risks associated with credit exposures. Restrictions on loan origination to financial firms prevent loan-originating funds from becoming intertwined with the broader financial system, which reduces systemic risks. It is reasonable that loan-originating funds should preferably be set up as closed-end funds. However, the chosen regulatory approach creates legal uncertainties, as it is unclear when, among other things, the envisaged 60% threshold takes effect.

## Liquidity management tools (LMTs)

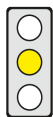
**Commission proposal:** AIFM managing open-ended AIFs or UCITS management companies will in principle have to have access to eight different liquidity management tools (LMTs). The Commission must adopt regulatory technical standards to specify the characteristics of the eight different LMTs and the criteria for the selection and use of the LMT. Competent authorities may require an AIFM or a UCITS management company to activate or deactivate a specific LMT.



**cep-Assessment:** The fact that AIFMs or UCITS management companies will in future be able to have recourse to at least eight different LMTs throughout the EU, improves investor protection and strengthens the stability of the financial markets. The fact that authorities will be able to (de)activate a specific LMT in future is double-edged. On the one hand, only AIFMs or UCITS management companies have sufficient knowledge about the right choice of LMT. On the other hand, they may not fully price financial stability risks into their decision-making calculus. Supervisors should only be allowed to intervene in an absolute emergency.

## Custody services

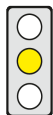
**Commission proposal:** Competent authorities may allow an AIF to appoint a depositary established in another Member State. The current AIFM Directive only allows AIFMs to appoint a depositary for the AIF which they manage if it is established in the same Member State as the respective AIF.



**cep-Assessment:** The fact that AIFMs in small and concentrated markets will in future be allowed to use depositaries in other EU countries, after approval by their supervisory authority, prevents them from having to resort to inefficient domestic depositaries and their services. However, the regulation can only be an interim solution. The Commission should harmonise national regulations, for example in securities law, in order to be able to quickly introduce an EU passport regime for depositaries as well. This is the only way to ensure cross-border competition in depositary services and to create a single market.

## Delegation arrangements

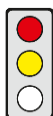
**Commission proposal:** AIFMs or UCITS management companies may delegate the performance of functions to third parties, subject to conditions ("delegation arrangements"). If the share of portfolio management or risk management functions delegated to third-country third parties exceeds their own retained share, the competent authorities of the AIFM or UCITS management company must report this to ESMA on an annual basis.



**cep-Assessment:** Strengthening transparency on delegation arrangements is appropriate, as this may increase supervisors' confidence in such delegations. However, the proposal still lacks legal clarity and certainty. In particular, it lacks clear and unambiguous criteria to determine whether the share of functions delegated by an AIFM or UCITS management company to third parties from third countries exceeds its own retained share.

## Investor protection

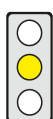
**Commission proposal:** AIFMs must in future inform investors in particular about "the possibility and conditions" of using an LMT (in the case of open-ended AIF), about certain fees, charges and costs, and about the portfolio of originated loans.



**cep-Assessment:** More clarity about a potential use of LMTs in the event of a crisis may enable investors to make a more informed investment decision ex ante. Additional disclosures on fees and charges are unnecessary. This is because they are often inaccurate in a quarterly disclosure and their collection is time-consuming and expensive. An annual disclosure requirement would therefore be sufficient.

## Reporting

**Commission proposal:** AIFMs or UCITS management companies must regularly report on all markets and instruments in which they trade, all exposures of their AIFs or UCITS funds, and all exposures in which the AIF or UCITS fund has invested. ESMA is required to submit a report on the "development of an integrated supervisory data collection", which should address possible duplications and inconsistencies between the numerous reporting requirements in the EU financial sector regulatory frameworks.



**cep-Assessment:** The preparation of a report by ESMA on the development of an integrated supervisory data collection is an appropriate first step. This is because AIFMs and UCITS management companies often have to report the same or similar information, at different times, in different ways and formats to diverse addressees, which often leads to unnecessary bureaucracy. At the same time, however, proposing an extension of the reporting obligations is not appropriate. It would make more sense to first wait for the planned consolidation of reporting obligations.