Asset Management & Investment Funds: EU & International Developments – April 2024

AIFMD II / UCITS Directive

AIFMD II (which includes updates to the UCITS Directive) is to be transposed by 16 April 2026, other than reporting obligations (where ESMA is tasked with developing RTS) which are to be transposed by 16 April 2027).

Some key areas of interest:

- An EU framework for loan originating AIFs, defined as AIFs:
  - whose investment strategy is mainly to originate loans or
  - where the notional value of the AIF's originated loans represents at least 50% of its net asset value.
- Increased information requirements for UCITS management company and AIFM authorisations on substance including increased conducting officers' resource requirements.
- Increased reporting on delegation/sub-delegation.
- Harmonised rules on the use and availability of liquidity management tools.
- A requirement for AIFMs to disclose a list of fees, charges and expenses that are borne by the AIFM in connection with the operation of the AIF, and that will be directly or indirectly allocated to the AIF. AIFMs will also be required to disclose on an annual basis all fees, charges and expenses that were directly or indirectly borne by investors.
- The possibility to appoint an AIF depositary located in another member state (subject to prior approval of the AIF's national competent authority).
- Measures to prevent possible misleading names to better protect investors.
- ESMA to undertake work to develop a common understanding of 'undue costs' (aligned with the retail investment strategy).
- Supervisory reporting.

As regards AIFMD, ESMA is to produce various guidelines, RTS and ITS including:

- Draft RTS on liquidity management by open-ended loan-originating AIFs (16 April 2025).
- Draft RTS specifying the characteristics of the liquidity management tools available to AIFMs managing open ended AIFs (16 April 2025).
- Draft guidelines on liquidity management tools (16 April 2025).
- Draft guidelines on the circumstances in which the name of an AIF is unfair, unclear or misleading (16 April 2026).
- Draft guidelines on the power of NCAs to initiate or end the suspension of a fund (16 April 2026).
- Report assessing the costs charged by AIFMs to the investors of the AIFs that they manage (October 2025).
- Draft RTS and ITS on supervisory reporting content and processes (16 April 2027).

- Report analysing market practices regarding delegation arrangements, scheduled for the next review of the AIFMD by the Commission).

As regards the UCITS Directive, ESMA is to produce various guidelines, RTS and ITS including:

- Guidelines on the selection and calibration of liquidity management tools by UCITS for liquidity risk management and for mitigating financial stability risks (16 April 2025).
- Report on the costs charged by UCITS and management companies to the investors (October 2025).
- Draft RTS to specify the characteristics of the liquidity management tools available to UCITS by (16 April 2025).
- Guidelines to specify the circumstances in which the name of a UCITS is unfair, unclear or misleading (16 April 2026).
- Guidelines on the power of regulators to initiate or end the suspension of a fund, (16 April 2026).
- Draft RTS and ITS on supervisory reporting content and processes (16 April 2027).
- a report analysing market practices regarding delegation arrangements (by 16 April 2029, scheduled for the next review of the UCITS Directive by the Commission).

ELTIF RTS

In December 2023, the European Securities and Markets Authority (**ESMA**) published its final report on draft regulatory technical standards (**RTS**) under the revised ELTIF Regulation (**ELTIF 2.0**). In March 2024, the Commission informed ESMA that it intends to adopt the proposed RTS with amendments and invited ESMA to submit new draft RTS reflecting the amendments provided, encouraging ESMA to consider the individual characteristics of the different ELTIFs and to take a more proportionate approach to the drafting of the RTS, particularly in relation to redemptions and liquidity management tools (**LMT**s).

On 19 April 2024, ESMA published an opinion on the RTS aimed to address the Commission's concerns. In its opinion, ESMA acknowledges that an appropriate balance should be found between the protection of retail investors and financial stability objectives and the important contribution that ELTIFs should make to the capital market union objectives. ESMA however proposes striking that balance slightly differently from the Commission recommending limited changes to the Commission's proposed amendments. The most important changes in the RTS relate to:

Notification of material changes to redemption policy

ESMA addressed the Commission's concerns that material change to the redemption policy should be notified to the national competent authorities (**NCA**s) before they occur (unless the material change is beyond the control of the manager of the ELTIF). ESMA proposes that the manager of the ELTIF shall give written notice of material changes to the NCA of the ELTIF as soon as possible and at least one month before implementing the change or as soon as the change becomes known to it where the change is not planned by the manager and is beyond its control.

Notice period for redemptions

Taking account of the Commission's feedback, ESMA has removed the mandatory minimum redemption notice period of 12 months for all ELTIFs. It also proposes that redemption notice periods are subject to the ELTIF holding a prescribed minimum percentage of liquid assets and a percentage limit of assets that can be redeemed, so that an ELTIF with a notice period of:

- less than one month would have to hold at least 25% in liquid assets and the percentage of assets that could be redeemed would be 20%
- less than three months to one month would have to hold at least 20% in liquid assets and the percentage of assets that could be redeemed would be 50%
- less than six months to three months would have to hold at least 15% in liquid assets and the percentage of assets that could be redeemed would be 67%
- less than 12 months to six months would have to hold at least 10% in liquid assets and the percentage of assets that could be redeemed would be 90%

ESMA also suggests that the requirement to justify the appropriateness of the notice period for the ELTIF and its investors to the NCA should be triggered if the notice period is less than six months (instead of three months).

Liquidity management tools

ESMA has removed the mandatory requirement to select and implement at least one anti-dilution LMT, limited to anti-dilution levies, swing pricing and redemption fees. Under the revised proposal the manager of the ELTIF may select one of these and subject to justification to the NCA of the ELTIF, it may also use other LMTs.

ESMA has also clarified that ELTIFs may implement redemption gates, in particular if the amount of liquid assets is not sufficient to cover a reasonable expected redemption at redemption dates, not limited to specific circumstances or contingent on the notice period.

The Commission may adopt the RTS with the amendments it considers relevant or it may reject it. The European Parliament and the Council may object to an RTS adopted by the Commission within a period of three months.

ESMA's T+1 feedback report

ESMA published feedback received to its call for evidence on shortening the settlement cycle.

In the report, ESMA summarises the feedback from market participants, focused on four areas:

- Many operational impacts beyond adaptations of post-trade processes are identified as resulting from a reduction of the securities settlement cycle in the EU.
- For ESMA to assess the appropriateness of shortening the settlement cycle and the costs and benefits of doing so, ESMA will need further information and understanding of issues which include (but are not limited to) the impacts on securities lending and borrowing, market making, and the repo market; FX trading; cross-border activities; corporate actions standards; and benefits resulting from margin reductions for cleared transactions.
- Respondents identified a wide range of both potential costs and benefits of a shortened cycle, with some responses supporting a thorough impact assessment before decisions are made.
- Respondents provided suggestions around how and when a shorter settlement cycle could be achieved, with a strong demand for a clear signal from the regulatory front at the start of the work

and clear coordination between regulators and industry.
- Stakeholders identified the need for a proactive approach to adapt their own processes to the transition to T+1 in other jurisdictions.
- Some responses warned about potential infringements due to the misalignment of the EU and North America settlement cycles and ESMA is currently assessing this.

ESMA will continue assessing the responses received, including the demands for regulatory/supervisory guidance. ESMA intends to include lessons learnt from the North American move to T+1 as well as any further feedback received from stakeholders in the Asia Pacific (**APAC**) region, from small and medium market participants and retail investors and their representatives. ESMA also intends to clarify the possible implications of T+1 for retail investors and smaller market players.

ESMA intends to deliver its final assessment to the European Parliament and to the Council before 17 January 2025.

FSB consultation on NBFI liquidity measures for margin and collateral calls

The Financial Stability Board (**FSB**) published a consultation report on liquidity preparedness for margin and collateral calls. The report sets out eight proposed policy recommendations to enhance the liquidity preparedness of non-bank market participants for margin and collateral calls in centrally and non-centrally cleared derivatives and securities markets (including securities financing such as repo).

- FSB report identifies weaknesses in risk management and governance as key causes of inadequate liquidity preparedness by some non-bank market participants during recent incidents of liquidity stress in financial markets.
- Report proposes eight high-level and cross-sectoral policy recommendations focused on managing and mitigating the impact of spikes in margin and collateral calls in the non-bank financial intermediation (**NBFI**) sector. They build on and complement existing rules and regulations on liquidity risk management across different sectors and jurisdictions.
- Recommendations cover liquidity risk management and governance, stress testing and scenario design, and collateral management practices of non-bank financial institutions.
- Recommendations apply to non-bank market participants that may face margin and collateral calls, including investment funds and are to apply proportionately.

The FSB identifies a need for policy adjustments to deal with liquidity strains in the NBFI sector arising from spikes in margin and collateral calls during times of market stress, such as the March 2020 market turmoil, Archegos, and the commodities markets turmoil and stress in liability-driven investment funds in 2022.

AIF exposures to commercial real estate

ESMA published data on exposures of AIFs to commercial real estate (**CRE**) markets in the EU as of 31 December 2022.

At the end of 2022, 3022 AIFs were pursuing a CRE strategy of which 2675 were AIFs marketed and/or managed by authorised EU AIFMs (Net Asset Value of €607bn). Within this sample, 2131 AIFs were pursuing primarily a CRE strategy, and 544 AIFs were pursuing partially a CRE strategy. In terms of geographical breakdown of the investments, 85% were EEA, leaving 15% as non-EEA.

Comparative figures to end 2021 were: 2789 AIFs were pursuing a CRE strategy of which 2480 were AIFs marketed and/or managed by authorised EU AIFMs (Net Asset Value of €543bn). Within this sample, 2002 AIFs were pursuing primarily a CRE strategy, and 478 AIFs were pursuing partially a CRE strategy. In terms of geographical breakdown of the investments, 88% were EEA, leaving 12% as non-EEA.

AML / CFT / FS

EU list of high-risk third countries

The European Commission adopted a delegated regulation amending the list of high-risk third countries under 4AMLD to:

- add Kenya and Namibia to the list of high-risk third countries under 4AMLD
- delete Barbados, Gibraltar, Panama, Uganda and the United Arab Emirates from that list

The delegated regulation will be submitted to the Council of the EU and the European Parliament for scrutiny. If neither objects, it will enter into force 20 days after it is published in the Official Journal of the European Union. This reflects outcomes of FATF February 2024 plenary meeting.

Directive harmonising penalties for breaches of financial sanctions obligations

A Directive setting new rules to harmonise criminal offences and penalties for the violation of EU restrictive measures (financial sanctions) is currently completing the EU legislative process. It will have a 12 month transposition deadline after it is published in the Official Journal.

Wolfsberg Group principles for auditing a financial crime risk management progamme

The Wolfsberg Group published a *framework* for auditing a financial crime risk management programme for effectiveness under the Wolfsberg Factors. The Wolfsberg Factors are set out in a December 2019 *statement on effectiveness*, which outlined what the group considers are the key elements of an effective AML/CFT programme.

Financial Sanctions: EU commission FAQs on outgoing transfer reporting

Following the introduction of Article 5r in the Council Regulation (EU) No 833/2014 of 31 July 2014, the European Commission published FAQs and the reporting template to be used for reporting under Article 5r as outlined below:

- From **1 May 2024**, and any legal person, entity and body established in the EU which is directly or indirectly owned more than 40% by:

(i) legal person, entity or body established in Russia

(ii) Russian national

(iii) natural person residing in Russia

will be required to report to its NCA, on a quarterly basis, any transfer of "funds" exceeding €100,000 outside of the EU, directly or indirectly, within two weeks of the end of the relevant calendar quarter in which the transfer was effected, whether the transfer was made in one or several operations.

- Under a second reporting obligation, which will apply from **1 July 2024,** credit and financial institutions will be required within two weeks of the end of each calendar semester (on a semi-annual basis), to report to their NCA information on all transfers of funds outside of the EU of a cumulative, amount over that semester, exceeding €100,000 that they initiated, directly or indirectly, for the EU legal persons, entities and bodies referenced at (i), (ii) and (iii) in the point above.
- Article 5r further requires Member States to assess the information received in accordance with the above reporting requirements to identify transactions, entities and business sectors that indicate a serious risk of breaches or circumvention of, or use of funds for purposes incompatible with the EU sanction framework against Russia (*Regulation (EU) 833/2014 or Council Regulations (EU) No 269/2014, (EU) No 692/2014 or (EU) 2022/263, or Council Decisions 2014/145/CFSP , 2014/386/CFSP , 2014/512/CFSP or (CFSP) 2022/266*). Member States are also required to regularly inform each other the European Commission of their findings.
- Once the European Commission receives information from Member States, the Commission must review the functioning of the reporting requirements provided for in Article 5r by 20 December 2024**.**

This measure is introduced under Council Regulation (EU) 2023/2878, which inserts a new Article 5r into Regulation (EU) 833/2014.

AML / CFT package

The EU's proposed legislative package of enhanced anti-money laundering and counter-terrorist financing rules was adopted by the European Parliament on 24 April 2024. The adopted texts comprise:

- Anti-Money Laundering Regulation
- Sixth Anti-Money Laundering Directive
- Regulation establishing an anti-money laundering authority

The European Commission published the following Q&As and factsheet:

The Council of the European Union is to adopt these proposals and they will then be signed and published in the Official Journal.

For more information on these topics please contact any member of A&L Goodbody's Asset Management & Investment Funds team.

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