THE INVESTMENT ASSOCIATION

June 2021

THE FRAMEWORK FOR ALTERNATIVE INVESTMENT FUNDS

THE SUCCESSFUL FOUNDATIONS OF THE AIFMD FRAMEWORK

AIFMD is a central pillar of the EU's fund regulatory regime. It established a robust framework for managers of alternative investment funds (AIFs) to ensure financial stability and enhance investor protection in Europe. Currently accounting for €7.12 trillion of assets, almost 40% of the EU fund industry, AIFs are mainly sold to professional investors and cover real estate, private equity, infrastructure funds and hedge funds. They prove a vital pool of capital for businesses and projects all around Europe and have a crucial role to play in the post-COVID-19 economic recovery, the green transition, and the development of the Capital Markets Union.

As stated by the European Commission in its 2020 report, the AIFMD works well and has created a globally successful brand attracting professional investors from all over the world. AIFMD strikes an appropriate balance between enhancing financial stability and ensuring investors are protected, while providing enough flexibility for managers to give their investors access to a wide range of competitive products. In this context, we argue that only limited and targeted amendments to the current regime are warranted. While we believe some steps could be taken to improve the efficiency of the framework, we trust these can be done through ESMA's existing and recently reinforced powers such as utilising peer reviews and its supervisory convergence network. To protect the international reputation of AIFs for institutional investors, we argue in favour of legislative stability and encourage regulators to preserve the following foundations on which the successful framework stands:

Meaningful disclosures and adequate safeguards for investor protection

The **mandatory disclosures** correctly address the information needs of professional investors, with the information requirements for retail investors being met through the broader EU regulatory framework, such as MiFID II and PRIIPs. In addition, AIFMD permits member states to set additional local requirements on funds that are marketed to retail investors without imposing unnecessary disclosures on professional investors. This flexibility recognises the diversity of funds structures in Member States while ensuring all investors are adequately protected and well-informed through high standards of transparency. AIFMD has also set many **operational requirements** to help ensure investors are appropriately protected, including robust rules to avoid conflicts of interests, strict liability standards for the safekeeping of the fund's assets, and appropriate valuation requirements.

About the Investment Association

The Investment Association (IA) represents the interests of more than 250 investment managers across Europe. Collectively, our members manage assets totalling more than €10.0trn, or 37% of the total assets managed in Europe, and do so through more than 640 offices. By allocating capital to businesses and projects in need of finance, our members help millions of individuals work towards their long-term financial goals and allow them to enjoy a more prosperous retirement.

Robust mechanisms to enhance financial stability

During the COVID-19 market turmoil, the live stress test confirmed that AIFs are operationally resilient and have sound liquidity management processes in place. In fact, only 0.3% of AIFs and UCITS had to suspend trading, most of them for valuation reasons and only for a limited period of time. This was mainly made possible by **Liquidity Management Tools** (LMTs) which allowed managers to absorb redemption shocks despite sizeable outflows. The flexibility given to managers to choose how to deploy these tools on a bespoke basis allowed managers to identify the tools most suitable for each fund based on their characteristics and liquidity profiles. This flexibility has proven more effective in managing crisis than rigid rules, and we, therefore, caution against any restrictive definition or practices on LMTs. **Fund liquidity reporting obligations** for AIFs also played a crucial part in preserving financial stability by equipping European and national supervisors with the necessary tools and data to prevent systemic risks.

As witnessed during the COVID-19 market-stress, reporting obligations and supervision in the choice of LMTs used by managers can be swiftly upgraded by ESMA in case of crisis. We, therefore, do not see the need for level one changes and believe greater transparency and harmonisation can be achieved through level three measures.

Integration of sustainability risks

As long-term investors, we strongly support integrating sustainability considerations into the decision-making and risk management processes to redirect more private capital into sustainable investments. To allow managers to support the green transition, we encourage the development of a clear and consistent framework across all financial products. The recent introduction of new requirements under SFDR and the relevant definitions regarding sustainability risks and principle adverse impacts also apply to AIFMs. We suggest that the effects of this incoming legislation are assessed before imposing any specific requirements on AIFMs, which could result in a complex and disjointed sustainability framework across different services.

It is also essential that any framework recognises the significant data challenges created by a lack of sophisticated quantitative data for some underlying investment categories. Therefore, any framework needs to allow flexibility in the way risk and adverse impacts are assessed. This should include the possibility to provide both quantitative and qualitative disclosures to ensure meaningful disclosures to investors while a broader sustainability reporting framework is developed across industries.

Investor access to global expertise through the ability to delegate

The AIFMD allows asset managers to delegate key functions, such as portfolio management and risk management activities, to entities with the appropriate expertise. This ability to delegate has been key to the development of the EU AIFs industry, giving investor access to a wider range of competitive products and global expertise and a more effective and cost-efficient administration of their funds.

As recognised by the Commission's own staff working document in 2019, current delegation arrangements function well when carried out under robust supervision and oversight by local NCAs. The current rules preventing the use of letter-box entities are sufficiently clear, with no evidence provided by ESMA or the Commission of market failure or an increased risk to financial stability. Entities delegating portfolio management functions remain wholly and legally responsible for this activity, with regulatory cooperation agreements supplementing the sharing of relevant information between authorities.

The introduction of any additional qualitative or quantitative limits on delegation would limit access for investors to specialist investment expertise, and undermine the global attractiveness of AIFs at a time when there is a pressing need to diversify the sources of capital for European investment post-COVID.

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