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LONG TERM INVESTORS

AIFMD Review

The views of the private equity industry

Executive Summary

The European private equity industry welcomes the comprehensive evaluation undertaken by the European Commission and wholeheartedly agrees with its conclusion that the **AIFMD is working well**, and that the review should focus on **targeted improvements**.

The current rules have been very successful in ensuring compliance and furthering the framework's policy aims amongst both EU firms and global firms doing business in the EU. **A broader review of the framework would not be justified** and could have a very negative impact on the ability of EU private equity fund managers to act as a bridge between investors looking for high returns and companies looking for funding, at a time where such capital has never been more needed.

Here are our core comments on the review:

a. Proportionate delegation rules

While we support measures that could shed more light on the use of letter-box entities, we would be reluctant to see any changes that would impede the ability of fund managers to delegate their core and non-core activities, for the benefit EU investors.

Today, delegation is, in many instances, a necessary pre-condition to fund managers overcoming national barriers to fundraise and invest cross-border in the EU and beyond. Non-calibrated amendments could have a disastrous impact on some smaller markets' ecosystem.

b. Coherent reporting requirements

Reporting to investors and to national competent authorities has undeniable benefits – both from an investor protection and financial stability perspective – but it creates compliance costs that are often overlooked.

The wide powers given to ESMA seem to tilt the current balance, which was widely seen as appropriate. Meanwhile, some specific changes (quarterly reporting about fees) are not appropriate for all types of funds.

c. Other relevant changes

We suggest inserting grandfathering clauses to the "tax blacklist" requirements to give more predictability to fund managers while reminding policymakers about the importance of better categorising certain types of sophisticated investors.

Introduction

The proposal to amend the AIFMD, introduced as part of the Capital Markets Union (CMU) package, recognises the crucial role asset managers, such as private equity and venture capital fund managers, play in the financing of the European economy by supporting management teams and acting as a bridge between investors and businesses.

Commitments made by institutional and sophisticated investors in all segments of private equity, from venture capital to growth through infrastructure and buy-out, help **deliver capital to businesses looking for funding and returns to investors in search of high return**. And as investors committed more than **€100 billion of capital in private equity**, companies backed by the asset class represented more than **10 million employees**[1].

In 2020 alone, active private equity ownership benefited more than 8,000 businesses, more than 86% of which were SMEs. The venture and growth capital end of the market supported businesses in **highly innovative industries** to deliver on the **twin digital and green transitions** that Europe is rightly pushing to be global leader in.

General comments

We welcome the targeted nature of the AIFMD review, which mainly focuses on areas related to delegation, loan-origination, and some reporting aspects of the Directive.

The European Commission's review provides clear confirmation that the current regulatory structure, which is now well-tested, is to a very large extent appropriate, and we agree. Against this backdrop, we are appreciative that the European Commission has taken the "if it ain't broke, don't fix it" approach.

Did you know?

Private equity funds are typically closed-ended, long-term and unleveraged and as such fundamentally different from other types of funds and their managers, including other kinds of AIFs/AIFMs such as hedge funds and retail-focussed UCITS funds. These characteristics mutsq be considered when harmonising the UCITS and AIFMD framework.

⇨ Look at our "The Good, the Hedge and the UCITS" paper for more details.

Even on more controversial amendments, the private equity industry's concerns and specificities have so far been taken into consideration. We see this as a recognition of the role our industry can - and will - play in the financing of the European economy, as our members are direct and active investors in businesses.

Delegation (Article 7 & 20)

Delegation is an essential component of private equity structures, and it is appreciated that the Commission's proposal acknowledges this. We recognise the importance of letter-box rules in the construction of the Single Market and the building of a robust market infrastructure subject to effective supervision. Nonetheless, delegation is such a crucial part of the fund management business

[1] Data from 2020 for the fundraising (Invest Europe Activity Data), from 2019 for the employment.

that any change to these rules need to be carefully considered to avoid disrupting legitimate business that benefits EU investors.

Delegation of ***core functions*** (portfolio and risk management, as defined in Annex I of AIFMD) permits European managers to develop on a global scale by **allowing them to easily perform some activities locally** and **offer their clients exposures across jurisdictions and markets** which may not be achieved via a centrally organised investment management system. Private equity managers engage in hands-on support for, and improvement of, businesses – without being physically close to the underlying businesses, private equity professionals would not be able to provide said support. This is why delegation is essential where private equity funds invest globally, or regionally.

On the other hand, delegation of ***non-core functions*** is necessary for smaller organisations to achieve **economies of scale**. Larger organisations will also typically rely on both internal and outsourced operational models, depending on what is most efficient for the running of the fund on behalf of its investors. Over time, many managers will go from one model to another and change again depending on market conditions and underlying efficiencies. Most non-core functions will be delegated to entities based within the same country as the manager.

Overall, delegation as a whole:

- **allows EU managers to invest in EU businesses** based in countries with low fundraising activity (as delegation helps allows managers based in one EU country to invest in another using local expertise)
- **increases the returns and access for EU investors** to transactions in global and emerging markets (as delegation brings teams close to assets and reduces costs)
- **fosters the role of the EU as a leading location** for global funds (as the ability to delegate makes European structures competitive vis-à-vis those based in other significant markets)

The importance of delegation from a private equity perspective

To understand the role of delegation is to understand the key importance for managers of having (access to) local expertise to perform their duties - whether it is expertise in the market where they raise a fund, the market in which they invest (or exit), administrative or accounting, or even regulatory/legal/tax expertise.

Larger financial players, such as credit institutions or investment often have branches or subsidiaries in the countries in which they invest or otherwise operate. But such an option is not feasible for the vast majority of the European private equity market. Indeed, most of the European teams are small and composed of a handful of individuals. For them, **delegating part of their activities to third parties is the only option to have sufficient expertise to fundraise and manage portfolios** in different locations thanks to the skills and market understanding of local investment professionals.

Delegation is the most efficient – and therefore less costly – manner to access the required local skills and expertise. It is, simply put, what is making the financing of businesses possible at a certain price… and sometimes what makes the financing of businesses possible at all.

By reducing costs for the fund (and thereby for the investors in the relevant fund), due to economies of scale and operational efficiencies, delegation has allowed managers to raise funds from investors in every European jurisdiction and has fostered competition on the broader private equity market, including venture capital. It has been key to develop a networked infrastructure to deal efficiently with the many obligations that come with entering new markets, whether they

relate to support to portfolio companies, relations with operating partners, regulatory compliance, marketing and finance.

Today delegation is needed to ensure businesses in a corner of Europe receive funding from managers based in another corner thanks to the investments made in the fund by investors based everywhere on the continent; in other words, delegation is **what allows the European private equity industry to be "European" (as opposed to being national) and to compete on the global level**. It is also what allows European investors to gain efficient access to global high return strategies.

We stand ready to engage with EU policymakers to **find the right balance between providing sufficient disclosure about delegated activities while avoiding discouraging delegation that has a genuine economic purpose** – and effectively allows managers to provide services more smoothly and less expensively to investors and investees.

While the European Commission's proposal largely respects the supervisory effectiveness and competitive benefits to the EU of the existing framework, we would like to draw the attention to a few specific points:

a) Delegation-related requirements and the role of ESMA (Article 20 of the Directive)

Relevant Article

1.AIFMs, which intend to delegate to third parties the task of carrying out, on their behalf, ***one or more of the functions listed in Annex I or of the services referred to in Article 6(4),*** *shall notify the competent authorities of their home Member State before the delegation arrangements become effective.*

[…]

NEW Article 38a

Peer review of application of the delegation regime

1. ESMA shall, on a regular basis and at least every two years, conduct a peer review analysis of the supervisory activities of the competent authorities in relation to the application of Article 20. That peer review analysis shall focus on the measures taken to prevent that AIFMs, which delegate performance of portfolio management or risk management to third parties located in third countries, become letter-box entities.

2. When conducting the peer review analysis, ESMA shall use transparent methods to ensure an objective assessment and comparison between the competent authorities reviewed.

The limited changes proposed to the delegation-related requirements are an indication that the delegation rules already provide significant and effective safeguards against inappropriate delegation arrangements, and we agree.

Nonetheless, the role given to ESMA in the peer review analysis of the application of the delegation regime – as well as the drafting of the relevant provision and some of the recitals - shows a departure from the current approach where delegation is welcomed to one where it is tolerated, and may raise legal concerns in light of the principle of subsidiarity. This ultimately creates a risk that delegation activities could in the future be used by competent authorities as a reason to restrict access to some markets.

As mentioned above, delegation is such an integral part of the existing business model that any minor alteration (and *a fortiori* significant alteration) could have a significant impact on the functioning of

the European asset management market, with consequences for the way funds are offered to investors and their ability to support businesses.

We consider it important to provide clear wording to ensure that the scope and objective of the ESMA peer review are well defined and these peer reviews are conducted in a manner commensurate with the subsidiarity principle. Namely, that ESMA is provided more information for the peer review i) only with respect to delegation of risk or portfolio management, and ii) only as far as the delegation is to an entity outside the Union, and iii) in view of preventing the creation of letter-box entities[2].

It should thus also be made clear that requirements introduced to curb the use of letter-box entities are primarily designed in respect of the delegation of **core functions** of the manager - with the objective of ensuring that the AIFMD shall not delegate too many of its core activities to third parties.

Would such clarification not be made, the ability of fund managers to delegate **non-core** functions could be at risk, with disastrous consequences on the ability of managers in all parts of the market to operate in an efficient manner. There should be no objection to an AIFM delegating non-core services such as fund administration or accounting, for example.

From that perspective, it would be worth clarifying in a recital that **delegation in itself is a helpful mechanism** and should not be discouraged provided appropriate and sufficient information is transmitted to national competent authorities and the rules set in the Directive are followed.

Finally, it could be made clearer that delegation notifications should only serve the purpose of improving information collection to the benefit of ESMA, but should not form the basis for future interventions concerning delegation arrangements. While it is obvious that delegation notifications could guide future policy decisions, the current wording seems to imply that such decisions are to be taken by ESMA and not by the co-legislators.

Proposed amendment

To ensure that the scope and objectives of the ESMA peer reviews are well defined and that such peer reviews are conducted in a manner commensurate with the subsidiarity principle, we would propose to amend Article 38a (and accordingly, to Article 101a) as follows:

NEW Article 38a

Peer review of measures taken to prevent letter-box entities ~~application of the delegation regime~~

1. ESMA shall, on a regular basis and at least every two years, conduct a peer review analysis of the supervisory activities of the competent authorities in relation to the application of Article 20. That peer review analysis shall ~~focus on~~ assess the measures taken to prevent that AIFMs, which delegate performance of portfolio management or risk management to third parties located in third countries, become letter-box entities.

2. When conducting the peer review analysis, ESMA shall use transparent methods to ensure an objective assessment and comparison between the competent authorities reviewed.

[2] From that perspective, the drafting of Article 38 appears to be wider in scope than intended - as stated in the Commission's Explanatory Memorandum following the review by the Regulatory Scrutiny Board, "ESMA should be provided with more information on delegation arrangements in the cases where risk or portfolio management is delegated outside the Union and make use of already available powers, such as conducting peer reviews". Conversely, ESMA should not be provided with more information or review delegation of non-core functions.

To avoid unintended outcomes, we would propose to insert the following recitals to clarify the legislator's intent that delegation is of course permitted and welcomed where the relevant conditions are fulfilled:

(4a) Subject to the requirements set out in this Directive, including provision of adequate information, an AIFM may delegate the carrying out of some of its functions on its behalf in accordance with this Directive so as to increase the efficiency of the conduct of its business, and to support the achievement of the AIF's investment strategy. Similarly, sub-delegation should also be permissible. AIFMs, however, remain responsible for the proper performance of the delegated functions and compliance with this Directive at all times.

[…]

*(6) To develop a **general** reliable overview of delegation activities in the Union governed by Article 20 of Directive 2011/61/EU and to **facilitate information collection and transparency** **~~inform future policy decisions or supervisory actions~~**, competent authorities should provide the European Securities and Markets Authority ('ESMA') with delegation notifications where an AIFM delegates more portfolio management, or risk management functions of the AIF, than it manages itself to entities located in third countries.*

An amendment to Recital 28 could also be considered to clarify the key role played by delegation:

*(28) To support supervisory convergence in the area of delegation ESMA should conduct peer review on the supervisory practices with a particular focus on preventing the creation of letter-box entities. ESMA's analysis of the peer reviews will feed into the review of the measures adopted in this Directive and inform the European Parliament, the Council and the Commission of any additional measures that may be needed to support the effectiveness of the delegation regimes laid down in Directive 2011/61/EU, **taking into account the essential role of delegation in creating a genuinely EU-wide market for AIFMs and investors also with a view to ensuring that EU AIFMs can benefit from a sound and effective EU legal environment to compete globally**.*

Finally, and perhaps most importantly, we would suggest reinserting in the text Recital 31 of the previous Directive clarifying that non-core activities are not covered by the provisions in Article 20, as letter-box entity concerns only relate to core activities:

(28a) The strict limitations and requirements set out on the delegation of tasks by AIFMs should apply to the delegation of management functions set out in Annex I. Delegation of supporting tasks, such as administrative or technical functions performed by the AIFM as a part of its management tasks, should not be subject to the specific limitations and requirements set out in this Directive.

b) Reporting requirements (Article 7 of the Directive)

Relevant Article

2. Member States shall require that an AIFM applying for an authorisation provides the following information relating to the AIFM to the competent authorities of its home Member State:
*(a) information about the persons effectively conducting the business of the AIFM, **in particular with regard to the functions referred to in Annex I, including:***
(i) a detailed description of their role, title and level of seniority;
(ii) a description of their reporting lines and responsibilities in the AIFM and outside the AIFM;
(iii) an overview of their time allocated to each responsibility;
(iv) a description of the technical and human resources that support their activities;
(b) information on the identities of the AIFM's shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings and on the amounts of those holdings;
(c) a programme of activity setting out the organisational structure of the AIFM, including information on how the AIFM intends to comply with its obligations under Chapters II, III, IV, and, where

applicable, Chapters V, VI, VII and VIII and a detailed description of the appropriate human and technical resources that will be used by the AIFM to this effect;
(d) information on the remuneration policies and practices pursuant to Article 13;
(e) information on arrangements made for the delegation and sub-delegation to third parties of functions as referred to in Article 20 ***and a detailed description of the human and technical resources to be used by the AIFM for monitoring and controlling the delegate****.';*

Our understanding is that the detailed list of requirements largely mirrors what is currently required from national competent authorities.

However, it is **more appropriate for such a list to be set out exhaustively on a maximum harmonisation basis**. Requirements should be foreseeable and consistently applied in different Member States.

Fund managers are already subject to an extensive list of requirements to provide regulators an overall understanding of their business structures, reporting lines, capital adequacy and expertise. Increasing the regulatory burden at the time of authorisation, in addition to the already robust set of requirements that it is subject to, may simply deter managers from operating from the EU.

It would also make sense to define more clearly, through appropriate recitals, that the purpose of such information should always remain to determine whether the manager would be found to have breached the principles set in Article 20 (typically the ability of the manager to justify delegation and for the delegate to be able to provide the services) and not to determine the extent to which it has delegated (or whether the manager has delegated more of its substantive responsibilities and activities than it has retained).

In other words, EU law should not discourage delegation *prima facie* – but only when such delegation has been deemed to create a letter-box entity to the detriment of investors and/or financial stability. We are also of the view that qualitative elements (such as effectiveness of oversight, due diligence and monitoring of delegates) should be taken into account. Overall, supervisors should not focus on assets managed outside the EU but on how much control is exercised from the EU.

The fundamental risk of the alternative, *prima facie,* approach will be to "throw sand in the wheels" of EU delegation practices, with ultimate consequences for the ability of managers to fundraise and invest across the EU…which will affect the financing of the businesses they support or the returns of the pension funds or insurance undertakings which invest in them.

Proposed amendment

We would suggest the following amendments to Article 7 to clarify that only the information presented in the Article should be required and not additional details that have not been foreseen under the Directive:

2. Member States shall require that an AIFM applying for an authorisation provides ~~*the following*~~ *information relating to the AIFM to the competent authorities of its home Member State:*

(a) the following information about the persons effectively conducting the business of the AIFM, in particular with regard to the functions referred to in Annex I~~*, including*~~*: […]*

[…]

(e) information on arrangements made for the delegation and sub-delegation to third parties of functions as referred to in Article 20 and a ~~*detailed*~~ *description of the human and technical resources to be used by the AIFM for monitoring and controlling the delegate.';*

We also suggest removing paragraph 5:

~~*Where an AIFM delegates more portfolio management or risk management functions to entities located in third countries than it retains, the competent authorities shall, on an annual basis, notify ESMA of all such delegations ('delegation notifications').*~~

We would also suggest amending the following recital:

*(7) In order to ensure consistent harmonisation of the notification process in the area of delegation, power should be delegated to the Commission to adopt regulatory technical standards by means of delegated acts pursuant to Article 290 of the Treaty on the Functioning of the European Union (TFEU) in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council to specify the contents, forms and procedures to standardise the notification process of the AIFMs' delegation arrangements, **taking into consideration the nature of the fund managers' activities**. The notification form should contain data fields indicating the activities making up the risk and portfolio management functions in order to determine **whether an AIFM effectively complies with provisions set in Article 20 of this Directive** ~~has delegated more of such functions than it has retained~~. Those regulatory technical standards should be adopted on the basis of a draft developed by ESMA.*

Concerns over the two natural person rules

While it is seen as appropriate in some markets (the rule is already in place in Luxembourg or Ireland), the two natural persons rules (Article 8, 1(c) and recital 35) may be problematic in some jurisdictions, such as France.

First, it is important to clarify that private equity firms are on average relatively small shops, which are often run by only a handful individuals. In entities with only two supervisors, specific situations, such as pre-retirement, flexi-working due to family reasons or work time sharing between different companies of a group, may very quickly lead to situations where firms are no longer compliant with the rules, especially in situations of transition, despite posing no concerns from a letter box entity perspective.

In order to avoid such a scenario, the text could be slightly amended so that, while the two-person rule is maintained, more flexibility is given to the full-time employment criteria:

*'(c) the persons who effectively conduct the business of the AIFM are of sufficiently good repute and are sufficiently experienced also in relation to the investment strategies pursued by the AIF managed by the AIFM, the names of those persons and of every person succeeding them in the office being communicated forthwith to the competent authorities of the home Member States of the AIFM and the conduct of the business of the AIFM being decided by at least two natural persons, ~~who are~~ **one of which is** either employed full-time by that AIFM or ~~who are~~ committed full-time to conduct the business of that AIFM, and who are resident in the Union meeting such conditions.*

Reporting (Article 23 & 24)

Regulators have legitimate interests in overseeing the activities of AIFs, notably from a financial stability perspective. It is also paramount for investors – including institutional investors - to have appropriate information about the costs of investing. However, **more disclosure is not necessarily better disclosure** and more harmonised reporting is not necessarily more appropriate reporting.

When assessing the proportionate level of detail of the reporting and the frequency at which it should be disclosed, **the cost/benefit ratio from the perspective of the investors** should be the policymakers' key driver.

While achieving their primary objectives of ensuring sufficient transparency, reporting rules should not force managers to disclose information that is disproportionate to the information needs of stakeholders and the risks involved. Reasons for this may range from the degree of sophistication of the investor to the nature of the investment (an investor in a long-term closed-ended fund holding illiquid underlying investments does not require the same information as one investing in an open-ended structure).

a) Reporting to competent authorities (Article 24)

Relevant Article

1. An AIFM shall regularly report to the competent authorities of its home Member State on the ~~principal~~ markets and instruments in which it trades on behalf of the AIFs it manages.

It shall provide information on the ~~main~~ instruments in which it is trading, on markets of which it is a member or where it actively trades, and on the ~~principal~~ exposures of each of the AIFs it manages.

[…]

6. ESMA shall develop draft regulatory technical standards specifying the details to be reported according to paragraphs 1 and 2. ESMA shall take into account other reporting requirements to which the AIFMs are subject and the report issued in accordance with paragraph 2 of Article 69b.

7. ESMA shall develop draft implementing technical standards specifying:

(a) the format and data standards for the reports referred to in paragraphs 1 and 2;

(b) the reporting frequency and timing.

Our industry's view prior to the review was that **current reporting requirements** (set out in Annex IV of the Delegated Regulation) **were appropriate** and allowed competent authorities to have the right amount of information. Our overall sentiment remains that any potential streamlining benefits would not match the sunk costs attached to a revision of the existing reporting architecture which was developed over the years. In other words, the industry's preference is for stability.

Moreover, we are wary of the Commission's suggestion that ESMA would be at liberty to determine the scope of the information that is given. New Recital 17 is particularly worrying in this regard. Some of the information, and the way it is reported, will indeed have significant implications for the managers and should be assessed extremely carefully at political level.

Overall, policymakers should keep in mind that any information has an inherent cost attached to it and that reporting requirements should be calibrated to avoid imposing costs that are disproportionate to any benefits. As the Commission itself noted, "any change to the supervisory reporting obligations is bound to entail significant compliance costs" – with consequences on the competitiveness of the European asset management industry.

As such, we call for additional caveats in the main body of the text to further clarify what information is actually warranted and at what frequency. For example, "full portfolio disclosure to supervisors" could represent significant costs for closed-ended fund managers (as it could require new calculations) with very little added benefits (as the information would be of little relevance and no import to financial stability).

Proposed amendment

We suggest reversing the proposed changes to Article 24 as follows:

1. An AIFM shall regularly report to the competent authorities of its home Member State on the **principal** markets and instruments in which it trades on behalf of the AIFs it manages.

It shall provide information on the **main** instruments in which it is trading, on markets of which it is a member or where it actively trades, and on the **principal** exposures of each of the AIFs it manages.';

[…]

To avoid creating an unnecessary burden on fund managers, we also suggest clarifying Recital 17:

*(17) In preparation for the ~~future~~ **necessary** changes to the supervisory reporting obligations the scope of the data that can be required from AIFMs should be widened by removing the limitations, which focus on major trades and exposures or counterparties. If ESMA determines that a full portfolio disclosure to supervisors on a periodic basis is warranted **taking account of the potential risks and benefits to investors**, the provisions of Directive 2011/61/EU should accommodate the necessary broadening of the reporting scope."*

b) Reporting to investors (Article 23)

Relevant changes

1. AIFMs shall for each of the EU AIFs that they manage and for each of the AIFs that they market in the Union make available to AIF investors, in accordance with the AIF rules or instruments of incorporation, the following information before they invest in the AIF, as well as any material changes thereof: […]

(ia) a list of fees and charges that will be applied in connection with the operation of the AIF and that will be borne by the AIFM or its affiliates […]

4. AIFMs shall, for each of the EU AIFs that they manage and for each of the AIFs that they market in the Union, periodically disclose to investors: […]

(e) on a quarterly basis, all direct and indirect fees and charges that were directly or indirectly charged or allocated to the AIF or to any of its investments;

We generally support the approach taken, which has not introduced significant modifications to the reporting schemes. AIFMs are typically only marketed to professional investors, which have experience in investing in the asset class and which negotiate the terms applicable to their involvement in the fund.

One of the main changes introduced is the need to disclose fees, including indirect ones, that relate to the operation of the AIF. As an industry, we fully support the principle that managers should disclose the fees and charges that are effectively applied to the investor in the fund. It is in the interest of both parties, managers and investors, that the information is shared and appropriate.

However, we are concerned about the suggestion made in paragraph (e) that *indirect* fees and charges should be disclosed *on a quarterly basis* in a private equity context. While this may be appropriate for open-ended funds, this level of frequency is not relevant or helpful in a private equity context, where fee and expenses provisions are negotiated and provided for in detail in the fund's constitutional documents, the investor has invested for a ten-year period, with no possibility to redeem its shares, and information on fees is not often available on a quarterly basis, or may change little from quarter to quarter.

It would be much more rational – and less costly – for both parties if this requirement were not attached to any given frequency (or at least were aligned with a yearly frequency, which is the

current market practice). Annual figures, which are audited, and also much more reliable and give the investor a better overview of the real costs it faces.

When it comes to fees applied "in connection with the operation of the AIF" and borne by the AIFM, it should be specified that these are specific to the fund (rather than general expenses of the AIFM in respect of its business and managed funds more generally). The wording "to any of its investments" should be deleted as the meaning remains unclear – and could lead to situations where the investor would receive information that is not meaningful.

Proposed amendment

We would suggest inserting the following article:

4. AIFMs shall, for each of the EU AIFs that they manage and for each of the AIFs that they market in the Union, periodically disclose to investors: […]

*(e) on a quarterly basis, **or on a yearly basis for closed-ended funds**, all direct and indirect fees and charges that were directly or indirectly charged or allocated to the AIF ~~or to any of its investments~~;*

An alternative could be to clarify that the frequency could depend on the type of fund:

(e) on a quarterly basis **at a frequency adapted to the nature of the AIF,** *all direct and indirect fees and charges that were directly or indirectly charged or allocated to the AIF* ~~or to any of its investments~~

Third countries (Article 35, 36, 37, 40 & 42)

Relevant Article

*the third country where the non-EU AIF is established is not identified as **a high-risk third country pursuant to Article 9(2) of Directive (EU) 2015/849**; […]*

*the third country where the non-EU AIF is established has signed an agreement with the home Member State of the authorised AIFM and with each other Member State in which the units or shares of the non-EU AIF are intended to be marketed, which fully complies with the standards laid down in Article 26 of the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information in tax matters, including any multilateral tax agreements, **and the third country is not mentioned in Annex I to the Council conclusions of 2020 on the revised EU list on non-cooperative jurisdictions for tax purposes***

Fighting tax avoidance and money laundering are two important priorities and it is understandable that changes have been introduced to the AIFMD to reflect recent developments in European law on both fronts.

We are therefore not opposed to the principle that the AML and the so-called "tax blacklist" shall be the relevant frameworks to determine whether a jurisdiction shall be considered as "high risk" and that either funds or managers based in these jurisdictions shall be excluded from the ability to market or be marketed in the Union.

However, we are concerned that this could create some unpredictability for fund managers, and we believe it would be worth clarifying further the way in which such requirements would apply. Indeed, compared to compliance with the standards in the OECD Model Tax Convention (which was previously the relevant criterion), a decision on the "tax blacklist" could virtually be instantaneous, which means funds could suddenly no longer be marketed as soon as a decision is taken.

First, this would naturally create **significant uncertainty for fund managers using the national private placement regimes** or, in the future, the third country passport. This uncertainty would be

particularly relevant in a closed-ended fund context, where marketing takes place over a one-to-two-year period, with extensive negotiations taking place between the manager and its investors to set up the capital of the fund.

Second, there is a real risk that, would a decision be taken during the fundraising process, a fund manager would need to stop marketing that specific fund and, on top of that, for a period of 36 months after de-notification, would not be allowed to engage in any pre-marketing of the AIF de-notified "or in respect of similar investment strategies or investment ideas" because of the (de-) notification rules under the CBDF legislation.

It is therefore essential to introduce **some grandfathering or transitional rules** to protect existing managers from the massive impact a political decision on the tax blacklist could have on their business.

Proposed amendment

We would suggest inserting the following clarification:

the third country where the non-EU AIF is established is not identified as ***a high-risk third country pursuant to Article 9(2) of Directive (EU) 2015/849****; […]*

the third country where the non-EU AIF is established has signed an agreement with the home Member State of the authorised AIFM and with each other Member State in which the units or shares of the non-EU AIF are intended to be marketed, which ~~fully~~ ***substantially*** *complies with the standards laid down in Article 26 of the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information in tax matters, including any multilateral tax agreements,* ***and the third country is not mentioned in Annex I to the Council conclusions of 2020 on the revised EU list on non-cooperative jurisdictions for tax purposes applicable at the time of the notification to the competent authorities of the AIFM home Member State***

Definition of professional investors

AIFMD only allows marketing to professional investors as defined under Annex II of MiFID, although Member States may allow AIFMs to market to retail investors at their own discretion (Article 43 of AIFMD).

Such a balance is appropriate from the perspective of the private equity industry. The vast majority (around 85%) of investors private equity fund managers will market will be professional investors under EU law. Half of the remaining share will come from institutions, such as universities, family offices or foundations (9%) and from private individuals (around 7%).

Most importantly, the few private individuals committing capital to private equity are usually high net worth individuals committing more than €100K into each fund and which are very aware of the specificities of investing into a private fund (they will usually have negotiated their commitment to it, including with the support of sophisticated specialist advisors).

In light of this, turning the AIFMD passport into an EU retail passport is not something the industry would encourage. In the few cases where fund managers wish to market to retail investors, the voluntary ELTIF label is seen as the perfect vehicle to do so.

This said, we have long argued that ***there is a fundamental issue with the definition of the professional investor category***, including the concept of a "professional investor upon request". The current definition indeed treats as retail clients investors who have the expertise of professional ones.

To apprehend the inadequacy of the current categorisation, and of the "professional upon request" test which relies among others on the number of investments (10) made in a calendar quarter, it is vital to understand that a (generally large) investment in a ten-year closed-ended fund with no redemption rights, often made after a negotiation with the fund manager on the terms of the investment, cannot be compared to a liquid daily trading activity and a number of 10 investments is completely unrealistic in that context.

Moreover, private equity investors do not necessarily need to have experience "in the financial sector" to be qualified and experienced for an investment in a private equity fund. In fact, in practice very often former entrepreneurs or members of management teams of private equity-backed companies who know the business in which the private equity fund invests are much more sophisticated than someone with, for example trading experience, in the financial sector. In practice, the MiFID test has become synonymous of "banking knowledge" and applying to other parts of the financial sector is wholly inappropriate.

We would suggest that the AIFMD review, as well as the upcoming MiFID review, provides an opportunity to recalibrate the definition of a "professional investor upon request" to better reflect the specificities of long-term investors – as has already been done in the context of the EuVECA and ELTIF Regulation.

Proposed amendment

We would suggest inserting the following changes to the definition of a professional investor in Article 4. Both additions are taken from existing texts – the EuVECA exemption (Article 6) and an ELTIF exemption (Article 30 of currently discussed review)

(ag) '*professional investor' means, for the purpose of this Directive, an investor*

- *which is considered to be a professional client or may, on request, be treated as a professional client within the meaning of Annex II to* ***Directive 2014/65/EC; or***
- ***which has committed to investing a minimum of EUR 100 000; and stated in writing, in a separate document from the contract to be concluded for the commitment to invest, that they are aware of the risks associated with the envisaged commitment or investment; or***
- ***which is a member of senior staff, portfolio manager, director, officer, agent or employee of the manager or of an affiliate of the manager and has sufficient knowledge about the AIF concerned.***

Other changes to the Directive

There are several sections in the AIFMD review proposal, which do not directly affect the private equity model. Our response therefore does not include comments on:

a) Loan-origination rules

Private equity funds only make equity investments in businesses, and it is not part of their activity to originate loans. However, an equity investor may structure part of their commitment to a portfolio

company as a debt instrument (or, indeed, as a preferred equity instrument). Where a private equity AIF subscribes for debt instruments in a company alongside an equity commitment, we would not regard the private equity fund as a loan-originating fund. Private equity backed companies may of course still use debt to finance themselves, on top of the equity they receive from the fund, but such debt will not come from the fund (nor from the manager) but from external credit institutions.

While some of the largest private equity houses may have different types of strategies of top of their private equity activities, from hedge fund to credit or real estate, this will be done within separate divisions of their group.

b) Liquidity rules

The private equity model at its core is about buying companies with potential to make them grow. While this requires capital and active involvement from the manager in the running of the business, it also requires a rare value in finance: time.

As a result, private equity funds are set up in a way which avoids the potential for fire sales of the sort that in other asset classes could drive down investment values and adversely affect other participants in the financial system. Private equity funds are in nearly all cases closed-ended entities set up for a period of around 10 years – with no redemption rights offered to the investors.

The liquidity risk associated with the activities of a private equity fund and the risk of maturity mismatch in connection with its investments is therefore non-existent as there is no short-term pressure to liquidate significant volumes of assets simultaneously.

We therefore welcome the recognition that **liquidity rules should not apply to closed-ended funds** and will not comment on this section. That said, we call on policymakers to be mindful not to apply liquidity requirements to funds which are not subject to these concerns (while recognising that investors must take into consideration the illiquid nature before making a long-term investment in an asset class such as ours).

Who we are

Invest Europe is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance and transparency from our members.

Contacting us

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