

INCEPTION IMPACT ASSESSMENT - DRAFT 26.08.2020

Inception Impact Assessments aim to inform citizens and stakeholders about the Commission's plans in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options.

TITLE OF THE INITIATIVE	Proposal for a Directive amending Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers
LEAD DG (RESPONSIBLE UNIT)	FISMA - Unit C4
LIKELY TYPE OF INITIATIVE	Legislative proposal
INDICATIVE PLANNING	Q3 2021
ADDITIONAL INFORMATION	The launch of the public consultation to be aligned with the CMU Action Plan to be announced in October 2020

The Inception Impact Assessment is provided for information purposes only. It does not prejudice the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by the Inception impact assessment, including its timing, are subject to change.

A. Context, Problem definition and Subsidiarity Check

Context

The Alternative Investment Fund Managers Directive (AIFMD) was adopted in the aftermath of the global financial crisis, which exposed certain weaknesses of the alternative investment management sector requiring to reinforce a coordinated supervisory oversight and to increase transparency towards investors. The AIFMD seeks to achieve a coherent approach of supervisory authorities to the risks of the financial system, to provide a high-level investor protection and also to facilitate AIFM market integration. AIFMs are required to manage financial and systemic risks adequately while ensuring the required levels of transparency regarding the activities of their managed alternative investment funds (AIF). The AIFMD also established a framework for the authorised AIFMs to manage and market AIFs to professional investors across the Union.

Article 69 of the AIFMD required the European Commission to start a review of the Directive in 2016 and provide a report to the European Parliament and the Council assessing the effectiveness of the AIFMD. An external contractor conducted a survey of market participants as part of the overall preparation of its report on the AIFMD. The Commission drew up and published its report on 10 of June 2020 (AIFMD report) reviewing the application and the scope of the AIFMD with an emphasis on the experience acquired in applying this Directive, its impact on investors, AIFs, AIFMs in the Union and in third countries.

The Commission found that the impact of the AIFMD on the AIFs and AIFMs has been largely positive with the AIFMD playing an important role in creating an internal market for AIFs and reinforcing the regulatory and supervisory framework for AIFMs in the Union. AIFMs are now operating with greater transparency for investors and supervisors. However, the report also identifies a number of areas where improvements could be made to the regulatory framework and a number of regulatory gaps that could be addressed to complete the development of a Single Market for AIFs.

Problem the initiative aims to tackle

In view of the on-going Commission's work to complete the Capital Markets Union, of which the AIFMD is one of the founding pillars, it should be assessed how a legislative proposal could tackle the identified hurdles for completing the Single Market for AIFs.

Whilst the responses received from the stakeholders to the general survey and further analysis indicated that while the AIFMD regulatory architecture is generally regarded as robust and effective, it is missing a number of important regulatory elements. For example, there is no passport for sub-threshold AIFMs and depositories meaning that these entities can only operate within their home Member State without full access to the benefits of the Single Market. There are no common rules for loan originating AIFs and AIFMs managing such funds are subject to varying rules in different Member States, which could be a challenge for preserving financial stability

and establishing a level playing field. Retail investor access also remains subject to national rules, which is an impediment for the creation of a single AIF market for retail investors. The AIFMD report signals that there is an issue with an uneven playing field with other financial intermediaries providing identical services, for example, MifiD firms and UCITS providing individual portfolio management.

From the macro-prudential perspective, the Commission will also assess potential enhancements to ESMA's supervisory powers particularly in relation to third country AIFMs. In view of recent Covid-19 related financial market turbulences, it should also be examined further whether the intervention powers and a tool-kit available to the relevant supervisors are sufficient to ensure systemic financial stability. Moreover, supervisors need to have relevant and good quality data to monitor risks to financial stability. An international approach to leverage reporting developed by IOSCO should be taken into account to permit better data comparability.

There are also a number of overlaps with other Union laws, such as reporting to the ECB for statistical purposes. Given the expansion of non-bank lending which is raising financial stability concerns, there may be a need to capture data on loan origination by AIFs.¹ More granular information on certain asset classes, such as leveraged loans and collateralised loan obligations (CLOs), as well as the information on direct and indirect linkages between the different financial sub-sectors (the banking, investment fund (UCITS and AIF) and insurance sectors) is currently missing but is relevant for effective macro-prudential oversight. The AIFMD report highlights a number of issues regarding the AIFMD rules as applied to the private equity fund sector. Effectiveness on transparency requirements when PE invests in private companies is judged as questionable. Given expansion of private markets, additional data capturing this data may need to be collected.

Finally, there are a number of technical clarifications necessary to improve legal certainty for an effective application of the Directive. The AIFMD report concludes that additional definitions and rules would facilitate improved regulatory compliance concerning, for example, tri-party collateral management, prime broker activities, investing on own account or delegation of AIFM functions to third parties.

The AIFMD review should contribute to the continued development of the internal market for AIFs by creating a comprehensive rulebook to enhance the efficiency of the EU capital markets ensuring effective macro-prudential supervision.

Basis for EU intervention (legal basis and subsidiarity check)

The Treaty on the Functioning of the European Union (TFEU) confers upon the European institutions the competence to lay down appropriate provisions that have as their object the establishment and functioning of the internal market (Article 114 TFEU). Depending on the policy option chosen and the specific design of the rules, the appropriate legal base could also be Article 53(1) TFEU on the taking-up and pursuing of activities by self-employed persons, which is used to regulate financial intermediaries, their investment services and activities.

The national rules mentioned in the section above can make the cross-border provision of services in relation to AIFs difficult and impede the development of the Single Market. The existence of diverging national approaches poses risks to the level playing field in the Single Market and overall financial stability, market integrity and competition. The AIFMD seeks to achieve a coherent approach across supervisory authorities to the risks of the financial system while ensuring high levels of investor protection and facilitating AIFM market integration. Member States cannot achieve these objectives individually, therefore, the Union may adopt measures in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union.

As regards proportionality, the AIFMD is one of the main pillars of the CMU. Any amendments proposed will respect the principle of proportionality, as set out in Article 5 of the Treaty on European Union, and would not go beyond what is necessary in order to achieve the objectives of completing a Single Market for AIFs and contributing to the process of building the CMU, while ensuring a coherent approach to macro-prudential oversight of the EU AIF market.

B. Objectives and Policy options

The overall objective of the initiative is to address the issues identified in the AIFMD report to improve the effectiveness of the Directive and contribute to the building of the CMU. This will be done in line with the current and future sustainable finance strategies integrating further environmental, social and governance-related sustainability considerations into the decision-making process of the financial sector.

Policy options will be structured to identify the most appropriate and proportionate approach to fulfil these objectives without creating undue administrative burdens.

Under a baseline scenario, the Commission would continue to monitor and maintain regular dialogue with ESMA,

¹ The role of non-bank financial institutions in the leveraged loan and CLO markets has increased. See Financial Stability Board, *Vulnerabilities associated with leveraged loans and collateralised loan obligations (CLOs)*, PLEN/2019/91-REV, 22 November 2019.

the National Competent Authorities (NCAs) and Member States as well as with market participants including asset managers and product manufacturers. ESMA will continue its role in coordinating achievement of a common understanding of the AIFMD rules and concepts among the NCAs and the industry.

The impact assessment, that will contain a back-to-back evaluation, will analyse several policy options, ranging from soft-law measures (e.g. ESMA's interpretative communications and/or Guidelines and/or Questions and Answers) to options including the introduction of targeted amendments to the AIFMD.

C. Preliminary Assessment of Expected Impacts [max 20 lines]

Likely economic impacts

Completing the EU AIF market will have a positive effect for the capital flows in the Union. Improved growth of the capital market and increased efficiency should positively affect economic development though increased investment in the real economy. Financing start-ups, growth of private companies or infrastructure investments would complement or offer a substitute for bank financing increasing overall levels of available capital for investment.

Improved marketing and distribution of EU AIFs as well as access to depository services in other Member States will provide a greater choice for investors and issuers, in particular in smaller markets. A more competitive market should exert downwards pressure on the level of fund fees prevalent in the EU.

Revised supervisory reporting requirements could lead to compliance cost reductions for the AIFMs. At the same time, collecting data that are more relevant for macro-prudential supervisors will allow for better monitoring of the AIF market to ensure financial stability.

The likely economic impacts of the various options will be analysed in more detail in the Impact Assessment.

Likely social impacts

It is difficult to estimate what direct social impact the AIFMD review could have. It can, however, be expected that this review is likely to have an indirect impact on social issues. Providing cost-efficient returns to investors within a well-functioning regulatory framework provides solid social impacts, which are difficult to measure. Portfolio companies could secure existing jobs or create new employment opportunities, as well as promote regional development. Creating employment opportunities because of the available capital would have an indirect positive impact on a labour market.

Likely environmental impacts

AIFs are important investors in environmental projects. Such markets and 'green' products are unavailable in certain Member States reducing the universe of potential investors and available capital. Better functioning EU AIF markets, in particular for sustainability-related products, would bring to the investors anywhere in the Union a wider range of AIFs, which could have a positive environmental impact.

Likely impacts on fundamental rights

The AIFMD complies with the fundamental rights and principles laid down in the Charter of Fundamental Rights of the European Union. The contemplated amendments to the AIFMD will continue to respect those rights and principles.

Likely impacts on simplification and/or administrative burden

Some of the potential AIFMD amendments could facilitate increased conduct of business across borders for market participants. For instance, allowing for an effective operation of the AIFMs and depository functions across EU borders might eliminate costs. The possibility to roll out a single marketing strategy, should a certain type of AIF be made accessible to the retail investors on the basis of harmonised requirements, could result in major economies for AIFMs and distributors of AIFs.

Whilst a revision of supervisory reporting may eliminate duplications with the existing Union laws, reworking the template to follow the IOSCO approach on leverage reporting and including additional data fields to better monitor financial stability risks may result in additional one-off costs to update the relevant IT software. Similarly, bringing CSDs definitively into the category of AIFs custodians could increase compliance costs, however, this is necessary for the investor protection.

D. Evidence Base, Data collection and Better Regulation Instruments

Impact assessment

An impact assessment, which will contain a back-to-back evaluation, is being prepared to support the preparation of this initiative and to inform the Commission's decision. The European Commission report and the Commission Staff working Document with a detailed analysis on the AIFMD functioning has been already submitted to the European Parliament and the Council.

Evidence base and data collection

In line with the general principles in the Better Regulation guidelines on the need for evidence-based impact assessments, the Commission has collected and will continue collecting evidence through several sources. The Commission will notably rely on:

- European Commission's [report dated 10 June 2020 assessing the scope and the functioning of the AIFMD \(COM\(2020\) 232 final\)](#) and respective [Commission Staff Working Document \(SWD\(2020\) 110 final\)](#) assessing the application and the scope of the AIFMD.
- [KPMG Report on the Operation of the Alternative Investment Fund Managers Directive \(AIFMD\)](#) – Directive 2011/61/EU dated 10 of December 2018.
- [ESMA letter](#) dated 18 August 2020 to the EVP Dombrovskis regarding Review of the Alternative Investment Fund Managers Directive.
- ESMA Annual Statistical Report EU Alternative Investment Funds [2019](#) and [2020](#).
- [Study on the distribution systems of retail investment products across the European Union dated April 2018](#).
- [FSB Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities dated 12 January 2017](#) and [Vulnerabilities associated with leveraged loans and collateralised loan obligations \(CLOs\)](#) dated 22 November 2019.
- [IOSCO Final Report on Recommendations for Liquidity Risk Management for Collective Investment Schemes of February 2018](#).
- [Recommendation of the European Systemic Risk Board of 7 December 2017 on liquidity and leverage risks in investment funds ESRB/2017/6, 2018/C 151/01](#).
- The content, feedback and the respective documentation surrounding the [public consultation on cross-border distribution of investment funds](#) (UCITS, AIF, ELTIF, EuVECA and EuSEF) across the European Union, as well as follow-up legislative proposals and policy actions.
- The content of the [European Commission's 2012 public consultation on investment funds](#) with a dedicated section on long-term investments, as well as a [dedicated informal questionnaire of 2013](#), which the Commission services circulated amongst professional stakeholders to gather further input, including the analysis of over 50 responses by private and public entity stakeholders on the subject-matter
- Analysis of the scope of the [European Green Deal](#) (Communication, COM(2019) 640 final, dated 11 December 2019) and the extent to which AIFs could be employed as a pass-through vehicle to facilitate the funding in the green transition in the public and the private sector.
- Documentation surrounding the CMU Action Plan, including the Communication from the Commission on ["Capital Markets Union: Progress on Building a Single Market for Capital for a Strong Economic and Monetary Union"](#) dated 15 March 2019.
- Analysis of academic and commercial publications on the topic of the practical issues pertaining to the functioning of the AIFMD framework.
- Market data on the size, asset flows and respective stakeholders in the area of alternatives by using Morningstar and the SAFE SURVEY.
- Publicly available reports, studies, surveys, position papers and other relevant documents drawn up by private and public stakeholders.
- Input from workshops, bilateral meetings and consultation with Member States and industry stakeholders, including asset managers, product manufacturers, retail investors representatives and investment funds active in alternatives investment.
- The results of the public consultation targeting all interested parties to be launched in October 2020.

Consultation of citizens and stakeholders

The European Commission will launch an open public consultation related to this initiative. The web-based consultation is an opportunity for all stakeholders (EU citizens, Member States, ESAs, NCAs, financial institutions, asset managers, investors etc.) to provide their views on the risks and opportunities related to the review of the AIFMD legal framework and the need for action and the possible solutions necessary in order to address the current issues. The public consultation will be published on the [EUSurvey](#) portal (open for 13 weeks). This consultation will represent one of the main sources of evidence for the impact assessment.

The Commission will also consult the Expert Group of the European Securities Committee (EGESC), and will continue to liaise with stakeholders through bilateral *ad hoc* contacts to help further substantiate the analysis of the available policy options in line with the Better Regulation guidelines. The Commission will also seek the policy input by the national competent authorities (NCAs) both directly and through the ESMA Investment Management Standing Committee (IMSC).

Will an Implementation plan be established?

Given that the AIFMD is a Directive, adoption of any amendments will be accompanied by an implementation plan, which should include implementation workshops.