



The Changing Face of EU Investment Fund Regulation

The Alternative Investment Fund Managers Directive (AIFMD) was introduced in response to well publicised failures in governance that impacted European Union (EU) funds during the global financial crisis of 2008-09.

The aim of the AIFMD was to ensure minimum regulatory standards for the operation of management companies responsible for funds available for investment in the EU and not captured by the pre-existing Undertakings for Collective Investment in Transferable Securities (UCITS) Directive.

Over time the AIFMD has evolved to include fund specific regulation, both as add on rules (such as the European Long-term Investment Fund, European Social Entrepreneurship Fund, and European Venture Capital Fund) and within the AIFMD itself, with the introduction of new rules governing loan originating alternative investment funds (AIFs). In this article we explore these new fund rules, as well as some of the other changes introduced by the amending directive.

Background

The changes to the AIFMD are the result of a scheduled review of its application and scope, which found that the original objectives of the AIFMD have been met.

However, the European Commission, one of the parties to the AIFMD review, alongside the European Parliament and the Council of the EU, concluded that there was a need to:

- “Harmonise the rules for the managers of alternative investment funds (AIFMs) managing AIFs which originate loans”;
- “Clarify the standards applicable to AIFMs that delegate their functions to third parties”;

- “Ensure equal treatment of entities providing custody services (custodians)”;
- “Improve cross-border access to depositary services”; and
- “Optimise supervisory data collection and to facilitate the use of liquidity management tools across the [EU]”.

Source: Directive (EU) 2024/927 – Recital 1

In addition to these conclusions, the European Commission found that a “*robust delegation regime, the equal treatment of custodians, coherent supervisory reporting, in particular through the removal of duplications and redundant requirements, and a harmonised approach to the use of liquidity management tools were also necessary for the management of [UCITS].*”

Source: Directive (EU) 2024/927 – Recital 2

As a result, a combined Directive amending both the AIFMD and UCITS Directive (the Directives) was proposed in 2021. The signed Directive ([\(EU\) 2024/927 as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds](#)) was published in the Official Journal of the EU on 26 March 2024 and came into force on 15 April 2024.

What follows is a factual summary of the content of the Directive.

What do the changes cover?

At a high-level, the amendments cover:

- Loan origination AIFs;
- Implementation and application of liquidity management tools;
- Authorisation requirements for AIFMs and UCITS management companies;
- Delegation to and by AIFMs and UCITS management companies;
- Disclosures to investors;
- Clarification regarding depositary delegation models when using a Central Securities Depository (CSD) and, for AIFs, the ability to appoint a third-country depositary when specific provisions are met;
- Regular reporting to national competent authorities (NCAs);
- Communication between NCAs;
- Restrictions on the third-countries where non-EU AIFMs may be established; and
- Old and out-of-date provisions that need removing (such as instructions to the European Securities and Markets Association (ESMA) to develop technical standards that have now been completed).

In this article we concentrate on rules that directly affect EU AIFMs and UCITS management companies.

The requirements in more detail

Loan originating AIFs

The AIFMD is amended to introduce rules governing the operation of loan originating funds.

Annex I (permitted functions of the AIFM) is amended to include originating loans on behalf of an AIF and servicing securitisation special purpose entities.

To enable the introduction of loan originating AIFs, new definitions are introduced covering:

- Capital of the AIF;
- Loan origination or originating a loan;
- Shareholder loan;
- Loan-originating AIF; and
- Leveraged AIF.

The rules relating to loan originating AIFs include:

- 20% limits on the notional value of loans to specific types of investor (e.g., AIFs, UCITS, and financial undertakings as defined in Solvency II, such as mixed financial holding

companies and investment firms as defined by the Markets in Financial Instruments Directive (MiFID)), including when the limit shall come into force, when it ends, and its temporary suspension where the capital of the AIF is increased or reduced;

- Leverage limits of 175% for open-ended AIFs and 300% for closed-ended AIFs;
- Restrictions on permitted borrowers;
- That proceeds of loan, less allowable fees, are attributable to the AIF in full;
- Prohibitions on:
 - Lending to consumers, as defined by the Consumer Credit Directive;
 - AIFs originating loans with the sole purpose of transferring those loans or exposures to third parties.
- Requirements for loan originating AIFs to retain 5% of the notional value of each loan originated.

The requirement that a loan originating AIF must be closed-ended, unless the AIFM is able to demonstrate to its home competent authorities that the AIFs liquidity risk management system is compatible with its investment strategy and redemption policy.

AIFs that engage in loan originating activities, that are in existence prior to the introduction of the new rules, benefit from a five-year transitional arrangement.

From now until 16 April 2029:

- AIFs will be deemed to comply with the rules relating to the 20% limit on loans to specified borrowers and leverage limits;
- Where the 20% or leverage limits are exceeded as at 15 April 2024, those exposures cannot be increased;
- Where the 20% or leverage limits are not exceeded, AIFs will not be able to increase exposure beyond the limits; and
- AIFs will be able to opt into the rules provided the home NCA of the AIFM is notified.

ESMA is instructed to develop draft regulatory technical standards (RTS) to determine the requirements that loan originating AIFs must comply with in order to maintain an open-ended structure. Those requirements shall include a sound liquidity management system, the availability of liquid assets and stress testing, as well as an appropriate redemption policy having regard to the liquidity profile of loan-originating AIFs.

These requirements shall also take due account of the underlying loan exposures, the average repayment time of the loans and the overall granularity and composition of the portfolios of loan-originating AIFs. *Target date 16 April 2025.*

Liquidity management

The Directives are amended to include detailed requirements for the liquidity management of open-ended funds, including the requirement to select at least two appropriate liquidity management tools (LMTs) from those referred to in the newly introduced AIFMD Annex V and UCITS Annex IIA.

The requirement to select at least two LMTs does not apply to funds operating as money market funds in accordance with the money market funds regulation, which need only select one LMT.

LMTs as detailed in AIFMD Annex V and UCITS Annex IIA:

1. **Suspension of subscriptions, repurchases and redemptions:** “Temporarily disallowing the subscription, repurchase and redemption of the fund’s units or shares.”
2. **Redemption gate:** “Temporary and partial restriction of the right of unit-holders or shareholders to redeem their units or shares, so that investors can only redeem a certain portion of their units or shares.”
3. **Extension of notice periods:** “Extending the period of notice that unit-holders or shareholders must give to fund managers, beyond a minimum period which is appropriate to the fund, when redeeming their units or shares.”
4. **Redemption fee:** “A fee, within a predetermined range that takes account of the cost of liquidity, that is paid to the fund by unit-holders or shareholders when redeeming units or shares, and that ensures that unit-holders or shareholders who remain in the fund are not unfairly disadvantaged.”
5. **Swing pricing:** “A pre-determined mechanism by which the net asset value of the units or shares of an investment fund is adjusted by the application of a factor (“swing factor”) that reflects the cost of liquidity.”
6. **Dual pricing:** “A pre-determined mechanism by which the subscription, repurchase and redemption prices of the units or shares of an investment fund are set by adjusting the net asset value per unit or share by a factor that reflects the cost of liquidity.”
7. **Anti-dilution levy:** “A fee that is paid to the fund by a unit-holder or shareholder at the time of a subscription, repurchase or redemption of units or shares, that compensates the fund for the cost of liquidity incurred because of the size of that transaction, and that ensures that other unit-holders or shareholders are not unfairly disadvantaged.”
8. **Redemption in kind [in-specie redemption]:** “Transferring assets held by the fund, instead of cash, to meet redemption requests of unit-holders or shareholders.”
9. **Side pockets:** “Separating certain assets, whose economic or legal features have changed significantly or become uncertain due to exceptional circumstances, from the other assets of the fund.”

Source: Quotes extracted from Directive 2011/61/EU Annex V and Directive 2009/65/EC Annex IIA

It should be noted that the redemption in kind LMT is only available to professional investors and at a pro rata share of the assets held by the fund. However, where a fund is only marketed to professional investors, or where the fund is an exchange traded fund that replicates an index, the requirement for a pro rata share is disapplied.

The UCITS Directive is amended to include a clause that excludes assets held in side pockets from UCITS investment restrictions.

AIFMs and UCITS management companies will have to notify NCAs when a fund is suspended or where other LMTs are used, “in a manner that is not in the ordinary course of business”.

And NCAs will have the power to instruct AIFMs and UCITS management companies to apply LMTs in exceptional circumstances. This power is extended to the host NCA of a fund that is marketed cross border.

Here the host NCA can request that the home NCA impose LMTs. If the home member state does not agree with this request it must provide justification to the host NCA, ESMA and, if necessary (e.g., where the request is because the host NCA believes the fund presents a risk to financial stability), the European Systemic Risk Board.

As these are high level requirements, ESMA has been requested to develop:

- Draft RTS to specify the characteristics of the LMTs set out in AIFMD Annex V and UCITS Annex IIA, taking account of the diversity of investment strategies and underlying assets of funds. Those standards shall not restrict the ability of AIFMs or UCITS management companies to use any appropriate LMT for all asset classes, jurisdictions and market conditions. *Target date 16 April 2025.*
- Guidelines on the selection and calibration of LMTs by AIFMs and UCITS management companies for liquidity risk management and for mitigating financial stability risks, recognising that the primary responsibility for liquidity risk management remains with AIFMs and UCITS management companies. They shall include indications as to the circumstances in which side pockets can be activated. They shall allow adequate time for adaptation before they apply, in particular for existing funds. *Target date 16 April 2025.*
- Guidelines providing indications to guide the competent authorities in their exercise of the powers to instruct AIFMs and UCITS management companies to activate or deactivate LMTs, and indications as to the situations that might lead to requests from host NCAs to home NCAs to act on their behalf being put forward. When developing these guidelines, ESMA shall consider the potential implications of such supervisory intervention for investor protection and financial stability in another Member State or in the EU. The guidelines shall recognise that the primary responsibility for liquidity risk management remains with AIFMs and UCITS management companies. *Target date 16 April 2026.*



Authorisation requirements

Conditions for taking up business

Both Directives are updated to reflect minimum requirements that AIFMs and UCITS management companies must meet in respect of additional services they may provide. Added to the list of additional services are:

- Provision of services to other parties and managing any conflicts of interest;
- Administration of benchmarks in accordance with the Benchmarks Regulation, with the restriction that AIFMs and UCITS management companies cannot be authorised to administer benchmarks which are used in the funds that they manage;
- AIFMD only – Credit servicing activities in accordance with the directive on credit servicers and credit purchasers; and
- UCITS Directive only – Reception and transmission of orders in relation to financial instruments.

Application for authorisation

The Directives are updated to include the minimum information NCAs must request relating to the persons effectively conducting the business of the AIFM or UCITS management company, its obligations under the Shareholder Rights Directive, and details of any delegation arrangements.

Conditions for granting authorisation

Both Directives are reinforced to include requirements for at least two “natural persons” who effectively conduct the business of the AIFM or UCITS management company to be domiciled (i.e., permanently live) in the EU.

In addition, AIFMs and UCITS management companies are required to report the list of Member States in which the units or shares of the fund are marketed by the AIFM or UCITS management company or by a distributor which is acting on behalf of that AIFM or UCITS management company.

The AIFMD is amended to include requirements that Member States will ensure that an authorised EU AIFM is able to market an EU AIF established as an employee share scheme and that such schemes can be marketed cross-border without further restriction.

Delegation

The Directives are amended to enhance the rules on delegation by AIFMs and UCITS management companies to third parties, reinforcing the requirements for AIFMs and UCITS management companies to maintain oversight and responsibility for the functions or services delegated.

There is also clarification that marketing undertaken by a distributor acting on its own behalf under MiFID or through insurance-based investment products under the Insurance Distribution Directive is not considered to be delegation.

ESMA is instructed to produce a report analysing market practices regarding delegation and compliance with the Directives, based on the data reported to the competent authorities in accordance with the Directives, and on the exercise of ESMA’s supervisory convergence powers. That report shall also analyse compliance with the substance requirements of the Directives. *Target date 16 April 2029.*

Conflicts of interest

Both Directives are amended to require an AIFM or UCITS management company to take steps to manage conflicts of interest where it is appointed to manage a third party’s funds and to supply detailed explanations and evidence of compliance.

The AIFM or UCITS management company is required to specify the reasonable steps it has taken to prevent conflicts of interest arising from the relationship with the third party or, where those conflicts of interest cannot be prevented, how it identifies, manages, monitors and, where applicable, discloses those conflicts of interest, to prevent them from adversely affecting the interests of the fund and its investors.

Reporting obligations to competent authorities

The Directives are amended to require AIFMs and UCITS management companies to report to NCAs information on delegation arrangements concerning portfolio management and/or risk management functions, covering:

- Information on delegates;
- The number of full-time equivalent human resources employed by the AIFM or UCITS management company for performing day-to-day portfolio management or risk management tasks within that AIFM or UCITS management company;
- A list and description of the activities concerning portfolio management and risk management functions which are delegated;
- Where the portfolio management function is delegated, the amount and percentage of the fund’s assets which are subject to delegation arrangements concerning the portfolio management function;
- The number of full-time equivalent human resources employed by the AIFM or UCITS management company to monitor the delegation arrangements;

- The number and dates of the periodic due diligence reviews carried out by the AIFM or UCITS management company to monitor the delegated activity, a list of issues identified and, where relevant, of the measures adopted to address those issues and the date by which those measures are to be implemented;
- Where sub-delegation arrangements are in place, information on the sub-delegates, their activities and the amount and percentage of the fund's assets which are subject to delegation arrangements in respect of the sub-delegates and the activities related to the portfolio management and risk management functions that are sub-delegated; and
- The commencement and expiry dates of the delegation and sub-delegation arrangements.

Disclosure to investors

The Directives are amended to include new requirements for disclosures in pre-sale and periodic information.

Both Directives are amended to clarify that the name of the fund is classified as pre-sale information. The fund name must not be unfair, unclear or misleading.

To ensure the uniform application of the rules relating to the name of the fund, ESMA is instructed to develop guidelines to specify the circumstances in which the name of a fund is unfair, unclear or misleading. Those guidelines shall take account of relevant sectoral legislation. The Directives state that sectoral legislation setting standards for fund names or marketing of funds takes precedence over those guidelines. It should be noted that, on 14 May 2024, ESMA published finalised guidelines on funds' names using ESG or sustainability terms. ESMA states that although it is mandated to produce guidelines relating to fund names under the amended directives, it will not revisit ESG or sustainability as it would be disproportionate. *Target date 16 April 2026.*

The AIFMD pre-sale disclosure rules are amended to reflect:

- The possibility of, and conditions for using, LMTs; and
- A list of fees, charges and expenses that are borne by the AIFM in connection with the operation of the AIF that are to be directly or indirectly allocated to the AIF.

AIF periodic disclosures are required to include:

- The composition of the originated loan portfolio (where applicable);
- On an annual basis, all fees, charges and expenses that were directly or indirectly borne by investors; and
- On an annual basis, any parent undertaking, subsidiary or special purpose vehicle utilised in relation to the AIF's investments or on behalf of the AIFM.

UCITS Annex I (contents of the prospectus) is amended to include details on how investors in a UCITS with different investment compartments may pass from one to another and the charges applicable.

ESMA is instructed to produce a report assessing the costs charged by AIFMs and UCITS management companies to the investors of the funds that they manage and explaining the reasons for the level of those costs and for any differences between them, including differences resulting from the nature of the funds concerned.

The report will be based on data on costs including all fees, charges and expenses which are directly or indirectly borne by the investors, or by the AIFM or UCITS management company in connection with the operations of the fund, and that are to be directly or indirectly allocated to the fund, provided by NCAs. *Target date 16 October 2025.*

Depositaries

The AIFMD is amended to give Member States the power to grant cross-border depositary arrangements for AIFs on a case-by-case basis.

AIFMs wishing to apply for this arrangement must be able to prove that there is a lack of depositary services in the home Member State of the AIF who are able to effectively meet the needs of the AIF, having regard to its investment strategy, and that the aggregate national depositary market in that Member State, managed by EU AIFMs, is less than EUR 50 billion.

In both Directives, the relationship between the depositary and any underlying CSD is clarified.

- Investor CSDs, are considered a custody delegate of the depositary, however they are not subject to the depositary due diligence, periodic review or ongoing monitoring requirements laid down in the Directives.
- Issuer CSDs are not considered to be a custody delegate.
- Both Directives are updated to include a new definition of "central securities depository" derived from the CSDR.



Regular reporting to NCAs

New requirements are introduced which cover reporting by the AIFM or UCITS management company to its home NCA and include:

- Regular reporting on the markets and instruments in which it trades on behalf of the funds it manages;
- The arrangements for managing the liquidity of the funds, including the current selection of LMTs, and any activation or deactivation thereof;
- The current risk profile of the funds, including the market risk, liquidity risk, counterparty risk, other risks including operational risk, and the total amount of leverage employed by the funds;
- The results of the stress tests performed; and
- The list of Member States in which the units or shares of the funds are actually marketed by the AIFM, UCITS management company or by a distributor which is acting on behalf of it.

ESMA is instructed to develop draft RTS specifying:

- a) The details of the information to be reported to NCAs in respect of the markets and instruments a fund trades, liquidity and risk management, and Member States where the fund is marketed;
- b) The appropriate level of standardisation of the information to be reported to NCAs in respect of the AIFM's or UCITS management company's delegation arrangements; and
- c) The reporting frequency and timing.

Target date 16 April 2027.

ESMA is also instructed to develop draft implementing technical standards specifying:

- a) The format and data standards for the reports to NCAs in respect of the markets and instruments a fund trades, liquidity and risk management, delegation arrangements, and Member States where the fund is marketed;
- b) The identifiers that are necessary to connect the data on assets, AIFMs, UCITS management companies and funds in the reports referred to in the Directives to other supervisory or publicly available data sources;
- c) The methods and arrangements for submitting the reports referred to in the Directives, including methods and arrangements to improve data standardisation and efficient sharing and use of data already reported in any EU reporting framework by any relevant competent authority, at EU or national level, taking into account the findings of the report to be issued by ESMA in respect of the development of the integrated collection of supervisory data, to be completed by 16 April 2026;
- d) The template, including the minimum additional reporting requirements, to be used by AIFMs and UCITS management companies in exceptional circumstances (i.e., stability and integrity of the financial system, or to promote long-term sustainable growth) as referred to in the Directives.

Target date 16 April 2027.

Communication between NCAs

The requirements for NCAs to report breaches by AIFMs or UCITS management companies in another Member State are enhanced, with greater detail on the reporting process, the obligations of the home NCAs, mediation by ESMA and the publication of information by ESMA of an NCA's failure to act.

In the AIFMD, requirements for NCAs to report breaches by a depositary subject to a permitted cross-border arrangement are also added.

Implementation timeline and next steps

Member States will have until 16 April 2026 to adopt and publish the necessary laws, regulations, and administrative provisions to ensure compliance with the amendments.

The majority of amendments will apply from 16 April 2026.

The exception being changes to the reporting obligations to competent authorities which will apply from 16 April 2027.

The impact of the amended Directives on AIFMs and UCITS management companies may be significant, especially AIFMs operating loan origination funds.

Although Member States have 24 months to transpose the new requirements into their local rules, AIFMs and UCITS management companies should take this opportunity to consider the new requirements and plan for the inevitable changes to their processes and procedures that are coming their way.



Please contact for further details:

David Morrison

Global Head of Trustee and Fiduciary Services
david.m.morrison@citi.com
+44 (0) 20 7500 8021

Amanda Hale

Head of Regulatory Services
amanda.jayne.hale@citi.com
+44 (0)20 7508 0178

Kelli O'Brien

United States
Head of Fund Administration
Product
kelli.a.obrien@citi.com
+1 617 859 3468

Ramesh Selva

North & South Asia (ex-Korea)
Head of Trustee & Fiduciary Services
ramesh.selva@citi.com
+65 6657 4142

Sung-Wook Han

Korea
Head of Trustee & Fiduciary Services
sungwook.han@citi.com
+82 22004 2162

Shane Baily

EMEA Head of Fiduciary Services
UK and Europe
shane.baily@citi.com
+353 1 622 6297

Jan-Olov Nord

EMEA Head of Fiduciary Services
Netherlands and New Markets
janolov.nord@citi.com
+31 20 651 4313

www.citibank.com/mss

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