

AIFMD II: The Impact of EU Reforms on Non-EU Sponsors Accessing European Capital

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This update reviews the changes introduced by the EU Alternative Investment Fund Managers Directive II and assesses the likely impact of such changes on non-EU sponsors of private investment funds that are marketed in the EU. On 26 March 2024, AIFMD II was published in the Official Journal of the EU.^[1] AIFMD II entered into force on 15 April 2024 and, subject to certain exceptions as noted below, EU member states will have until 16 April 2026 to transpose the new rules into EU member state law.^[2] This update reviews the changes introduced by AIFMD II and assesses the likely impact of such changes on non-EU sponsors of private investment funds that are marketed in the EU. **What is AIFMD II?** Following its consultation on the application and scope of the EU Alternative Investment Fund Managers Directive (“**AIFMD[3], the European Commission concluded that there was a need to harmonise the regulatory framework applicable to alternative investment fund managers (“**AIFMsAIFsWhat is AIFMD II changing?** AIFMD II does not mark a complete overhaul of the AIFMD. Rather, the Directive adopts targeted amendments to address certain ambiguities identified within the existing regulatory framework. For non-EU sponsors of private investment funds that are marketed in the EU, the key changes relate to: the national private placement regime criteria; the reporting (Annex IV) and disclosure (Article 23) requirements; the delegation of portfolio management to third parties; the creation of a new loan origination regime; and the mandated use of liquidity management tools for open-ended funds. **What is the likely impact on non-EU sponsors?** AIFMD II was the subject of extensive debate among the European supervisory authorities, individual EU member states and the wider fund management industry. In particular, the proposals concerning the delegation of portfolio management and loan origination resulted in intensive negotiations. Fundamental changes to the AIFMD that would have been indicative of a more concerted move to “Fortress Europe”—for example, removing the ability of EU AIFMs to delegate portfolio management to non-EU sponsors—were not realised. That being said, AIFMD II is indicative of the trend towards tightening the avenues through which non-EU sponsors can raise EU capital, which is likely to further narrow over time. As a result of AIFMD II, there will also be a mismatch between requirements that apply to certain non-EU sponsors and those that apply to EU AIFMs, in particular, with respect to the application of the new loan origination provisions. It remains to be seen, however, whether AIFMD II will further push EU investors to prioritize investment in EU-domiciled AIFs. The impact of AIFMD II on non-EU sponsors will primarily depend on how individual sponsors raise capital from European investors and the investment strategies that they deploy. Non-EU sponsors are currently impacted by AIFMD when they: (a) market AIFs in EU member states via the national private placement regimes (“**NPPRs****

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respect to the AIF is nearly always delegated back to the sponsor's home jurisdiction (e.g., the United States). **What is the impact for non-EU sponsors accessing European capital via the NPPRs or an EU-affiliated AIFM / "host-AIFM"?** *(i) Investor disclosures* Both EU AIFMs and non-EU sponsors that have registered AIFs for marketing via the NPPRs are required to make certain pre-contractual disclosures available to EU investors (i.e., the Article 23 disclosures).^[4] Under AIFMD II, the Article 23 disclosures have been enhanced and will require the following information to be made available to investors: (i) the name of the AIF; (ii) a list of all fees, charges and expenses borne by the AIFM which are subsequently directly or indirectly allocated to the AIF or to any of its investments; and (iii) for open-ended funds, a description of the circumstances triggering the use of liquidity management tools. EU AIFMs and non-EU sponsors that have registered AIFs for marketing under the NPPRs will also be required to provide information periodically to investors, including: (i) all fees and charges that were directly or indirectly borne by investors; (ii) any parent undertaking, subsidiary or SPV utilised in relation to the AIF's investments by or on behalf of the AIFM; and (iii) to the extent applicable, a report on the portfolio composition of any originated loans. *(ii) Annex IV reporting* EU AIFMs and non-EU sponsors that have registered AIFs for marketing in the EU are currently required to submit periodic "Annex IV" reports. The Annex IV reports cover quantitative disclosures in respect of the AIFM and the AIFs it manages, and are due on an annual, biannual or quarterly basis (depending on assets under management, the use of leverage and the investment strategy of the AIFs). AIFMD II introduces additional reporting fields in the Annex IV reports. ESMA has been mandated to publish updated reporting templates by 16 April 2027 and, as a result, compliance with the additional reporting fields will not be required until that date. Currently, an EU AIFM (or a non-EU sponsor marketing an AIF in the EU pursuant to the NPPRs) must report on the "principal" markets and instruments in which it trades and provide information on the "main" instruments in which it is trading and on the "principal" exposures and "most important" concentrations of each of the AIFs it manages. AIFMD II expands the Annex IV reporting obligations by removing the limitations which focus on major trades and exposures or counterparties. AIFMD II also requires the provision of information regarding the total amount of leverage employed by the AIF as well as details on the member states within which the AIF is marketed. Detailed information on portfolio management / risk management delegation (including quantitative data) will also need to be reported. Given the expanded scope of reporting, the revised Annex IV reports are likely to impose additional costs and require additional resources to prepare them. **What is the impact for non-EU sponsors marketing via national private placement regimes?** *(i) Changes to accessing the NPPRs* Historically, most non-EU sponsors have accessed EU capital by registering their AIFs under the various EU member state NPPRs. AIFMD II will now prohibit the marketing of non-EU AIFs established in jurisdictions identified as "high risk" under the Fourth Anti-Money Laundering Directive (the "EU AML List").^[5] Similarly, to be eligible for registration under the NPPRs, non-EU AIFs will also need to be formed in jurisdictions that have signed agreements with the EU member state(s) in which they are to be marketed that are compliant with various international tax treaties. Finally, registration under the NPPRs will also be prohibited for any non-EU AIF that is established in a country that is included on the EU's list of non-cooperative tax jurisdictions.^[6] From the perspective of a non-EU sponsor, these amendments are not expected to be an issue for fund vehicles established in the United States. Any change to the scope of jurisdictions that are contained on the EU's list of "high risk" and "non-cooperative" jurisdictions is ultimately an EU political decision. That noted, the Cayman Islands was only recently removed from the EU AML List on 7 February 2024. In addition, on 23 April 2024 the European Parliament rejected the European Commission's proposal to remove the UAE from the EU AML List.^[7] Future changes in political headwinds could, therefore, result in other fund domiciles being added to such lists, which would effectively prohibit AIFs established in such jurisdictions from being marketed in the EU. To the extent that a popular fund domicile (e.g., the Cayman Islands) is added to one of the prohibited lists, this would have negative implications for non-EU sponsors seeking to access EU capital. **What is the impact for non-EU sponsors that have an EU-affiliated AIFM or use a "host-AIFM"?** *(i) Delegation* The changes introduced by AIFMD II to the AIFMD delegation provisions are not as extensive as the industry originally feared. Importantly,

the ability to delegate portfolio management to non-EU countries, such as the United States, remains. However, the changes outlined below indicate: (i) an increased level of scrutiny over delegation arrangements, including the “host-AIFM” model; and (ii) the costs and administrative burden of delegating an EU AIFM’s functions is likely to increase.

AIFMD II expressly provides that an EU AIFM is responsible for ensuring that the performance of functions and the provision of services by a delegate comply with the AIFMD. This requirement applies irrespective of the location or regulatory status of the delegate (i.e., even if the delegate is a non-EU sponsor). The degree to which this obligation results in a greater compliance burden for non-EU sponsors remains to be seen. That noted, EU AIFMs are likely to impose greater initial due diligence and ongoing monitoring requirements in the context of a delegation of functions, which is likely to add to the time and resources that are necessary to put such arrangements in place and to maintain them.^[8] In addition, EU AIFMs will also be required to regularly provide information to their competent authority regarding delegation arrangements that concern portfolio management or risk management functions. For example, this information includes but is not limited to: (i) details of the delegate(s); (ii) the number of full-time equivalent human resources employed by the AIFM for the purposes of performing day-to-day portfolio management or risk management tasks and to monitor the delegation arrangements; (iii) a list and description of the activities concerning risk management and portfolio management functions which are delegated; and (iv) the number and dates of the periodic due diligence reviews carried out by the AIFM to monitor the delegated activity (ii).

Loan origination The most fundamental changes in AIFMD II concern sponsors that manage AIFs operating loan origination strategies, either through an EU-affiliated AIFM or via the engagement with a “host-AIFM”. Separate requirements are applicable to loan origination activity by “AIFs Which Originate Loans” and “Loan Originating AIFs”.

Importantly, the restrictions that apply to AIFs Which Originate Loans and Loan Originating AIFs do not apply to AIFs marketed in the EU by a non-EU sponsor pursuant to the NPPRs. **“AIFs Which Originate Loans”** An “AIF Which Originates Loans” refers to an AIF that: (i) grants loans directly as the original lender; or (ii) grants loans indirectly through a third party or special purpose vehicle, which originates a loan for or on behalf of the AIF, or for or on behalf of an AIFM in respect of the AIF, where the AIF or AIFM is involved in structuring the loan, or defining or pre-agreeing its characteristics, prior to gaining exposure to the loan. With respect to “AIFs Which Originate Loans”, AIFMD II imposes commercial and operational restrictions, including:

- **Concentration limits** – Cannot make loans to a single financial undertaking, a UCITS or other AIF which exceeds, in the aggregate, 20% of the capital of the AIF—except if the AIF is selling assets to meet redemptions or as part of the liquidation of the AIF.
- **Lending restrictions** - Cannot make loans that could give rise to certain conflicts of interest, including to: the EU AIFM (or its staff); any entities within the same group as the EU AIFM; the EU AIFM’s delegate (or its staff); or the AIF’s depositary (or its delegate).
- **Risk retention** - Must retain 5% of each originated loan that is subsequently transferred to a third party.^[9]
- **Originate to distribute** - EU AIFMs cannot manage AIFs Which Originate Loans with the sole purpose of selling them to third parties.^[10]
- **Use of proceeds** - The proceeds of the loans, minus any allowable fees for the administration of such loans, must be attributed in full to the concerned AIF. Any such costs and expenses must also be included in the Article 23 disclosures.
- **Policies / Procedures** - EU AIFMs of AIFs Which Originate Loans will be required to implement and review policies and procedures relating to the granting of credit.

“Loan Originating AIFs” A “Loan Originating AIF” refers to an AIF: (i) whose investment

strategy is mainly to originate loans; or (ii) where the notional value of the AIF's originated loans represents at least 50% of its net asset value. In addition to the restrictions applicable to AIFs Which Originate Loans noted above, a Loan Originating AIF is also subject to the following limitations:

- **Leverage Limit**—leverage is limited to no more than: (i) 175% for open-ended Loan Originating AIFs; and (ii) 300% for closed-ended Loan Originating AIFs.^[11] The foregoing leverage limits do not apply to Loan Originating AIFs whose loan activity consists solely of originating shareholder loans, provided that such loans do not exceed in aggregate 150% of the capital of the Loan Originating AIF.
- **Closed-Ended Structure**—Must be closed-ended unless the EU AIFM can demonstrate that its liquidity risk management system is compatible with its investment strategy and redemption policy.

“Grandfathering” measures For the 5-year period from when AIFMD II comes into force (i.e., through 15 April 2029), the leverage limits, concentration limits and the requirement to be closed-ended do not apply to pre-existing AIFs. In addition, if such AIFs do not raise further capital after 15 April 2024, they are exempt indefinitely from these requirements. However, these grandfathering measures provide limited relief in practice. This is because: (i) if such AIFs are currently in breach of the leverage / concentration limits as at 15 April 2024, they cannot increase leverage or lending during the 5 year grandfathering period; and (ii) such AIFs that are not in breach of these requirements may only increase leverage / concentration to such level that they do not breach these limits. Pre-existing AIFs also do not need to comply with the other loan origination rules set out above. ⁽ⁱⁱⁱ⁾

Liquidity management tools for open-ended AIFs AIFMD II requires EU AIFMs operating open-ended AIFs to select at least two liquidity management tools, which must be appropriate to the investment strategy, the liquidity profile and the redemption policy of the AIF. These include: (i) suspension of redemptions and subscriptions; (ii) redemption gates; (iii) extension of notice periods; (iv) redemption fees; (v) swing pricing; (vi) dual pricing; (vii) anti-dilution levies; (viii) redemptions in kind; and (ix) side pockets. There are circumstances in which certain liquidity management tools can be activated or deactivated, or EU AIFMs may suspend the repurchase or redemption of units in the AIF. The use of liquidity management tools must be documented in policies and procedures and included in the Article 23 disclosures that are made available to investors. **What steps should non-EU sponsors be taking now?** At a high-level, certain aspects of AIFMD II (e.g., the expanded scope of Article 23 disclosures and Annex IV reporting) are consistent with the trajectory of private funds regulation in other jurisdictions, including the United States. Akin to the private fund rules that the U.S. Securities and Exchange Commission (the “SEC”) recently adopted^[12] as well as other rules currently proposed by the SEC, AIFMD II is similarly focused on increased transparency with respect to private funds both for investors and for regulators. While some elements of AIFMD II may not have a meaningful impact for many non-EU sponsors, key components of the Directive are likely to impose additional costs and operational burdens. For loan originating funds, AIFMD II goes further by limiting certain commercial flexibilities that were previously negotiated matters among investors, fund sponsors and transaction counterparties. For now, non-EU sponsors should be undertaking a gap analysis and impact assessment of AIFMD II on their EU operations and fund distribution strategy. Sponsors should also monitor the forthcoming EU Level 2 legislation and implementing legislation in key EU member states where they have a physical presence, engage a “host-AIFM” provider or market their funds. Should you have questions regarding AIFMD II and its potential implications on your business, please do not hesitate to reach out to the authors of this alert. ^[1] Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds. ^[2] References in this client alert to the “EU” should also be deemed to include the three European Economic Area jurisdictions as the context allows (i.e., Iceland, Liechtenstein and Norway). ^[3] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment

Fund Managers. [4] For EU AIFs managed by EU AIFMs, the obligation to make the Article 23 disclosures available to investors lies with the EU AIFM. That noted, the non-EU sponsor will typically prepare the Article 23 disclosures for funds marketed via the marketing passport (irrespective of whether the fund is managed by an affiliated-EU AIFM or a “host-AIFM”). [5] As at the date of this client alert, the following jurisdictions are on the EU’s AML list: Afghanistan; Barbados; Burkina Faso; Cameroon; Democratic Republic of the Congo; Gibraltar; Haiti; Jamaica; Mali; Mozambique; Myanmar; Nigeria; Panama; Philippines; Senegal; South Africa; South Sudan; Syria; Tanzania; Trinidad and Tobago; Uganda; United Arab Emirates; Vanuatu; Vietnam; and Yemen. [6] As at the date of this client alert, the following jurisdictions are on the EU list of non-cooperative tax jurisdictions: American Samoa; Anguilla; Antigua and Barbuda; Fiji; Guam; Palau; Panama; Russia; Samoa; Trinidad and Tobago; US Virgin Islands; and Vanuatu. [7] This decision has created a divergence in the treatment of the UAE, as the Financial Action Task Force removed the UAE from its “grey list” in February 2024. [8] Notably, there are additional requirements for EU AIFMs managing AIFs on behalf of third parties (i.e., the “host-AIFM” model) to provide additional information to their competent authority with respect to their management of conflicts of interest. [9] The AIF must retain that percentage of the loan: (i) until maturity for those loans whose maturity is up to eight years, or for loans granted to consumers regardless of their maturity; and (ii) for a period of at least eight years for other loans. Note that there are a number of exemptions including where the EU AIFM seeks to: (a) redeem units or shares as part of the liquidation of the AIF; (b) comply with EU sanctions or product requirements; (c) implement the investment strategy of the AIF, in the best interests of its investors; and/or (d) dispose of the loan due to a deterioration in the risk associated with the loan, detected by the AIFM as part of its due diligence and risk management process and the purchaser is informed of that deterioration when buying the loan. [10] This is likely to apply to loans that are originated indirectly by an SPV. [11] Leverage is expressed as the ratio between the exposure of the Loan Originating AIF and its net asset value. For the purposes of calculating this ratio, borrowing arrangements which are fully covered by contractual capital commitments from investors in the Loan Originating AIF do not constitute exposure. [12]

<https://www.gibsondunn.com/guide-to-understanding-new-private-funds-rules/>

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Gibson Dunn’s lawyers are available to assist in addressing any questions you may have regarding these developments. If you wish to discuss any of the matters set out above, please contact the Gibson Dunn lawyer with whom you usually work, any member of Gibson Dunn’s Global Financial Regulatory or Investment Funds teams, or the following authors: Michelle M. Kirschner – London (+44 20 7071 4212, mkirschner@gibsondunn.com) James M. Hays – Houston (+1 346 718 6642, jhays@gibsondunn.com) Martin Coombes – London (+44 20 7071 4258, mcoombes@gibsondunn.com) © 2024 Gibson, Dunn & Crutcher LLP. All rights reserved. For contact and other information, please visit us at www.gibsondunn.com. Attorney Advertising: These materials were prepared for general informational purposes only based on information available at the time of publication and are not intended as, do not constitute, and should not be relied upon as, legal advice or a legal opinion on any specific facts or circumstances. Gibson Dunn (and its affiliates, attorneys, and employees) shall not have any liability in connection with any use of these materials. The sharing of these materials does not establish an attorney-client relationship with the recipient and should not be relied upon as an alternative for advice from qualified counsel. Please note that facts and circumstances may vary, and prior results do not guarantee a similar outcome.

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