

## Understanding AIFMD II: delegation

Insights - 30/04/2024

In this series of briefings from our Investment Funds team in Luxembourg, we are summarising changes to the Alternative Investment Fund Managers Directive (AIFMD)<sup>[1]</sup>, which came into force on 15 April 2024<sup>[2]</sup>.

Member States have 24 months to transpose these changes to AIFMD (the AIFMD II)<sup>[3]</sup> into their national laws. In this second article, we are focusing on changes to the regime of delegation and sub-delegation, as well as precisions on the performance of the marketing function in the context of delegation.

### AIFMD II and delegation

In order to ensure a robust delegation regime, which would enable managers of alternative investment funds (AIFMs) to apply harmonised and standardised rules when delegating their functions to third parties, the EU Commission has introduced the following precisions with regards to delegation.

#### Definition of delegation

In this context, the definition of delegation, including its range of applicability, which has been substantially broadened, has been reformulated. In particular, with regard to the marketing function, the new provisions attempt to fill the existing regulatory gap<sup>[4]</sup> by clarifying under which conditions the delegation rules apply.

As a consequence, market players will need to review their own delegation framework and eventually assess compliance of the agreements in force.

Now it has been clarified that delegation occurs when the AIFM intends to entrust third parties with the performance, on its behalf, of one or more of the AIFM functions referred to in Annex I to the AIFMD or of the ancillary services referred to in Article 6(4) of the AIFMD.

With respect to the delegation of functions, this new definition reflects the current view

represented by the European Securities and Markets Authority (**ESMA**) according to which an AIFM entrusting third parties with the performance of any of the functions stated in point one and point two of the above mentioned Annex I, remains responsible for ensuring compliance with the AIFMD regime[5].

The Luxembourg regulatory guidance and market practice is already aligned to this interpretation, considering that the delegation framework applies with regard to all the functions referred to in Annex I of the 2013 Law[6]. Services listed in Article 6(4) of the AIFMD will enter into the Luxembourg national framework accordingly.

## Delegate compliance with AIFMD

Already bearing ultimate responsibility for AIFMD compliance, it is now expressly provided that going forward the AIFM will need to ensure any delegate or sub-delegate, irrespective of its regulatory status or location, complies with AIFMD requirements when performing any delegated functions or services.

## Delegation of the marketing function

With reference to the marketing function which is stated in Annex I and is therefore subject to the delegation rules, the revised text contains a partial derogation by clarifying that the delegation regime only applies when this function is being carried out by the distributor on behalf of the AIFM.

On the contrary, when the AIF is being marketed by a distributor on its own behalf and under Markets in Financial Instruments Directive (**MiFID II**)[7] or Insurance Distribution Directive (**IDD**)[8], the provisions of the AIFMD II should not apply, irrespective of any distribution agreements in place.

The reasoning of the stated exemption lies in the need to acknowledge the diversity of distribution arrangements with the aim to consequently avoid over-regulation on one side and overlapping of regulations on the other.

Consequently, the marketing performed by fund distributors that are *per se* subject to the regulatory requirements pursuant to the MiFID or IDD framework respectively, and which is carried out without the AIFM's knowledge, is not to be considered as a delegated function. In such a case, in fact, the scope and extent of the distributor's responsibility towards its clients is already defined by the applicable provisions.

On the contrary, when the distributor performs the marketing function on behalf of the AIFM, hence acts as a delegate of the AIFM, the latter is responsible for ensuring that the appointed distributor and its sub-distributors comply with the provisions of the AIFMD II.

## Conflicts of interest related to third-party initiators

Alongside the existing obligation to identify, mitigate and monitor conflicts of interest, separate reporting obligations were added in relation to structures in which an AIFM manages (or intends to manage) an AIF at the initiative of a third party, including where AIFs use the name of the third-party initiator or the third-party initiator is appointed as a delegate. Going forward, AIFMs will have to provide to their home regulators detailed explanations and evidence of compliance with the above obligations, specifying reasonable steps taken to prevent conflicts of interest or, where these cannot be prevented, how they identify, manage, monitor and disclose those conflicts of interest in order to prevent them from adversely affecting the interests of the AIF and its investors.

Even though the elements of the overall conflict of interest management are not new, it will still be on the national regulators to provide for supervisory expectations on the granularity of explanations and evidence the AIFMs will have to provide under the AIFMD II. In that regard, the CSSF has already provided for detailed regulatory expectations in the Circular 18/698.

## Substance requirements and disclosures to competent authorities

Necessarily linked to delegation, a new statutory minimum has been introduced in relation to the conduct of the AIFM's business - it will have to be carried out by at least two natural persons either employed on a full-time basis, or by executive members or members of the governing body of the AIFM, which are committed on a full time basis. In any case, these employees will have to be domiciled in the EU. Practice of the Luxembourg CSSF, enshrined in the Circular 18/698, already aligns with these requirements. When applying for authorisation, the AIFM will have to provide more detailed information in relation to the persons effectively conducting its business, including their roles, seniority, reporting lines, time allocation to each responsibility, and finally, technical and human resources supporting their activities.

The EU Commission has highlighted that regardless of this minimum, more resources might be necessary depending on the size and complexity of the AIFM and AIFs it manages,

The AIFMD II introduces a list of minimum information on (sub) delegation arrangements that AIFMs must provide to the relevant competent authority when applying for authorisation .

*Inter alia*, the applicant will need to (i) specify identification details of each delegate, (ii) describe the resources allocated for the performance of day-to-day portfolio management or risk management tasks and in parallel the monitoring of the delegated activity, (iii) illustrate the delegated portfolio management or risk management function including the information regarding whether the relevant function is being delegated partially or fully, and (iv) provide information on the measures which have been set up to periodically monitor the delegated activity.

Where the AIFM delegates portfolio management or risk management, the corresponding information will have to be provided to the competent authority as a part of ongoing reporting.

In that case, the AIFM will have to transmit information on, inter alia, (i) delegates, their regulatory status and links to the AIFM, (ii) number of FTE human resources employed by the AIFM performing day-to-day portfolio or risk management tasks within the AIFM and those employed by the AIFM to monitor the delegation arrangements and, (iii) the amount and percentage of the AIF's assets which are subject to portfolio delegation arrangements.

## Conclusion

Acknowledging the market reality, the EU Commission has intended to provide additional clarifications to market participants on what will and what will not be seen as delegation, as well to alleviate regulatory overlapping with existing regimes.

At the same time, it has demonstrated the intent to reasonably reinforce substance requirements and reduce market risks by strengthening the oversight of delegation arrangements through more detailed disclosures to competent authorities.

Several points remain which would need to be clarified, main one being providing further guidance on the distinction between the standalone and delegated performance of the marketing function.

## How can Ogier help?

Our dedicated Investment Funds team in Luxembourg can advise funds and their managers on compliance with the new rules and their implementation. For more information, please reach out to the team listed below.

To find out more about AIFMD II and loan origination, read our briefing from the team: [Understanding AIFMD II: loan origination.](#)

[1] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

[2] The AIFMD II intends to amend the UCITS directive as well, however in this series, we will be covering only the proposed amendments to the AIFMD.

[3] 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

[4] For example, certain jurisdictions in principle don't apply the delegation framework to the marketing function. As a result, in addition to legal uncertainty, market players experiment major difficulties when negotiating cross-border marketing agreements.

[5] ESMA34-32-352, Questions and Answers, Application of the AIFMD, June 2023, Section VIII, Question and Answer 2.

[6] Law of 12 July 2013 on alternative investment fund managers. This definition of delegation is to be found in the Circular CSSF 18/698, Chapter 6, Sub-chapter 6.2.

[7] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast)

[8] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast)

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