BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

Ref: European Commission Public Consultations on the Review of the Alternative Investment Fund Managers Directive (AIFMD)

Link to consultation:

- https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12648-Financial-services-review-of-EU-rules-on-alternative-investment-fund-managers

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BETTER FINANCE Response

Executive Summary

General comment	The very name of AIFs should be changed, as it is very misleading and does not comply with MiFID rules: it is unclear to what these are "alternative". Many non-professional investors understand alternative investment management as hedge funds. However, the reality is much different as AIFs include a lot of retail long-only funds. This labelling does not comply with MiFID which requires investor information to be clear and intelligible. The vast majority of EU individual "alternative investment fund" investors do not even know the AIF acronym, and don't understand they have invested in AIFs instead of UCITS, and what it means in terms of investor protection.
Marketing & distribution to non-professional investors	The rules on marketing of Alternative Investment Funds (AIFs) to individual, non-professional investors do not require improvement, but reform. Currently, there is no pan-EU market for "retail" AIFs due to the different national rules on the distribution of local and cross-border AIFs. Moreover, due to the uneven rules on direct vs indirect (packaged) distribution of AIFs in EU Member States, many individual investors gained exposure to AIFs indirectly, while investing in plain vanilla securities has become very difficult.
Disclosures	Unfortunately, the disclosure regime under the AIFMD (Art. 23) delivered more meaningful information (where the UCITS KIID was not extended by national rules to retail AIFs like in France) to non-professional investors than the PRIIPs KID regime. BETTER FINANCE recommends exempting AIFs from the PRIIPs KID disclosure (and applying the UCITS KIID regime) until the full, overdue Level 1 and 2 reviews of the PRIIPs Regulation are finalised.
Sustainability	In terms of non-financial disclosures by AIFs, a clear definition of principal adverse impact needs to be provided. At the moment, the regulation fails to provide such a clear definition. The concept of materiality needs to be in line with non-financial reporting directive and needs to be assessed according to 2 dimensions (double materiality): 1. the potential and/or the actual impact of sustainability risks on the performance, reputation and activities of the companies over the short and long-term (this includes also the financial materiality of the company). 2. the potential and/or actual impact of sustainability risks outside the company (that includes the environment, society, communities etc.,) over the short and long-term. Therefore, the disclosure process should be based on a double materiality assessment based on a clear definition of these 2 aspects. In the long term, ESG risks and opportunities can become financially material, and therefore should be integrated in financial decision-making.

Key information

Summary of the consultation papers (PC): The European Commission (EC) launched two separate public consultations on the review of the regulatory framework for alternative investment funds (AIFs) and European long-term investment funds (ELTIFs). However, since ELTIFs are a sub-set of AIFs, for reasons of simplicity, BETTER FINANCE decided to gather input from its members in a joint document. The input and BETTER FINANCE's research will be submitted in two separate responses to the European Commission, but the stylised version of the responses will be published in this document.

Structure: The document analyses the **AIFMD review:**
The consultation paper published by the EC on the review of rules on alternative investment funds comprises two versions: one short version, available in 23 languages, and one full (long) version, available in English. BETTER FINANCE selected the long version, of which it filtered the questions most relevant and important for "retail" investors. The consultation is structured in seven sections:

- Authorisation and scope of the AIF license;
- Investor protection;
- International issues;
- Financial stability;
- Private investments;
- Sustainability;
- Coherent approach with UCITS.

Link to the files:
- https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/2020-aifmd-review-consultation-document_en.pdf

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About BETTER FINANCE

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

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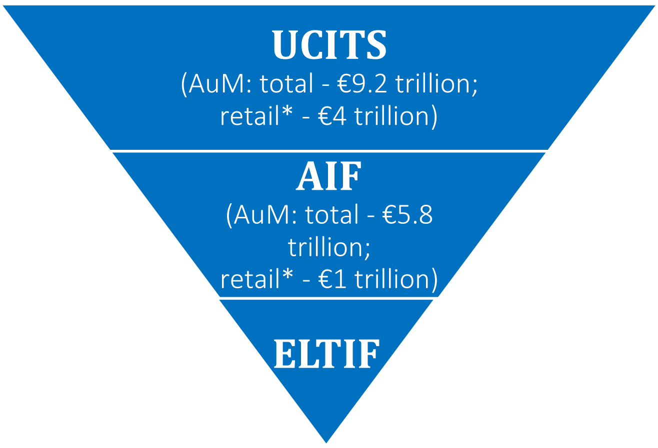
Background information

The EU regulates two main mutual fund types: UCITS (undertakings for collective investment in transferable securities, the most "popular" among EU individual investors[1]) and AIFs (alternative investment funds). AIFs are similar to UCITS but represent a more specialised, riskier category of mutual funds and are designed for a smaller, more affluent category of individual, non-professional ("retail") investors in the EU. The UCITS and AIF are complementary as all "mainstream" cross-border investment funds in the EU that do not qualify as UCITS can qualify as AIFs.

AIFs are regulated through the Alternative Investment Fund Managers Directive (AIFMD),[2] and are subject to the PRIIPs KID (*packaged retail and insurance-based investment products' key information document*) disclosure regime.

A subset of AIFs are the European long-term investment funds (ELTIFs). This fund category was designed by the EU to respond to a particular, less liquid and under-funded market segment of private equity, property and infrastructure projects. ELTIFs require a long-term (7 to 10 years) commitment from investors, are even less liquid and have limited redemption possibilities.



Adopting a very simplistic approach, it can be said that UCITS are intended for the vast majority of "retail" investors, followed by AIFs with a more restricted universe of investors, followed by ELTIFs which can be considered the most "specialised" of all three.

***Note:** For ELTIF, we do not know the actual size of the assets under Management (AuM).*

Source: BETTER FINANCE own composition; AuM data from the ESMA Annual Statistical Report on Cost and Performance of Retail Investment Products in the EU (2020); *direct distribution

Note: In preparation of the public consultation on ELTIFs, BETTER FINANCE undertook a research report on *Obstacles to the Development of an EU ELTIF Market*, published in December 2020.[3]

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[1] See https://ec.europa.eu/info/business-economy-euro/growth-and-investment/investment-funds_en.

[2] 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, http://data.europa.eu/eli/dir/2011/61/2019-01-13.

[3] BETTER FINANCE ELTIF Report [TBC]

General comment

The very name of AIFs should be changed, as it is very misleading and does not comply with MiFID rules: it is unclear to what these are "alternative". Many non-professional investors understand alternative investment management as hedge funds. However, the reality is much different as AIFs include a lot of retail long-only funds. This labelling does not comply with MiFID which requires investor information to be clear and intelligible. The vast majority of EU individual "alternative investment fund" investors do not even know the AIF acronym, and don't understand they have invested in AIFs instead of UCITS, and what it means in terms of investor protection.

Summary: The European Commission set to review the Directive on Alternative Investment Fund Managers (AIFMD) and raises 102 questions divided in seven sections. BETTER FINANCE chose only those sections and questions that are relevant for individual, non-professional ("retail") investors and concern: general aspects on the AIFMD framework, investor protection, supervisory reporting, sustainability/ESG aspects and miscellaneous (such as the UCITS & AIF single rulebook).

Functioning of the AIFMD regulatory framework, scope and authorisation requirements

Question 1. What is your overall experience with the functioning of the AIFMD legal framework?

- Very satisfied
- Satisfied
- Neutral
- Unsatisfied
- Very unsatisfied
- Don't know / no opinion / not relevant

Unsatisfied

Question 2. Do you believe that the effectiveness of the AIFMD is impaired by national legislation or existing market practices?

- Fully agree
- Somewhat agree
- Neutral
- Somewhat disagree
- Fully disagree
- Don't know / no opinion / not relevant

Somewhat agree

Question 2.1 Please explain your answer to question 2, providing concrete examples and data to substantiate it:

The effectiveness of the AIFMD – from a retail investor standpoint – is firstly impaired by the Directive itself, as the very name "AIF" is misleading and not intelligible for non professional individual ("retail") investors, and as it allows different national regimes for the marketing and distribution of AIFs. The AIFMD contains a very short provision on retail distribution of AIFs (Art. 43), simply stating that it is up to Member States to decide whether AIFs can be distributed to retail investors in their jurisdiction or not, and under what conditions. In turns, this triggers:

- **Legal barriers to cross-border distribution** – an AIF cannot be passported in another jurisdiction and sold to retail investors if the rules in that jurisdiction do not allow their own AIFs to be sold to retail investors, or if the standard of investor protection is higher or is considered higher than in the Member State of origin (meaning that the conditions of distribution are more stringent); e.g. in Germany, the supervisor (BaFin) allows passporting of EU AIFs for semi-professional investors, but not for retail investors;

- **Fragmentation**: the fact that all Member States can establish their own, distinct, rules for the marketing of AIFs to retail investors means that an AIF manager will prepare an AIF for distribution in one specific jurisdiction, which leads to a fragmentation of the single market.

Based on the desk research done by BETTER FINANCE, the reality is that passporting retail-AIFs in the single market is very limited, almost always requiring an authorisation or licence in the host Member State.

Moreover, there seems to be a legislative loophole on packaging rules: where AIFs may not be distributed to retail investors per se (in some EU Member States), these can be packaged in other products (such as life insurances) and then sold to them; in other words, any limitation on retail distribution can nevertheless be circumvented through insurance distribution, which has a lower standard of investor protection.

Question 3. Please specify to what extent you agree with the statements below:

BETTER FINANCE fully disagrees with all three statements.

The AIFMD has been successful in achieving its objectives as follows:

	1 (fully disagree)	2 (somewhat disagree)	3 (neutral)	4 (somewhat agree)	5 (fully agree)	Don't know - No opinion - Not applicable
creating internal market for AIFs	○	○	○	○	○	○
enabling monitoring risks to the financial stability	○	○	○	○	○	○
providing high level investor protection	○	○	○	○	○	○

Concerning the other statements, BETTER FINANCE's somewhat disagrees on the first statement, whereas the last four statements are, in our view, concerning asset managers or finance professionals. – therefore will be marked as "Neutral".

Other statements:

	1 (fully disagree)	2 (somewhat disagree)	3 (neutral)	4 (somewhat agree)	5 (fully agree)	Don't know - No opinion - Not applicable
The scope of the AIFM license is clear and appropriate	◯	◯	◯	◯	◯	◯
The AIFMD costs and benefits are balanced (in particular regarding the regulatory and administrative burden)	◯	◯	◯	◯	◯	◯
The different components of the AIFMD legal framework operate well together to achieve the AIFMD objectives	◯	◯	◯	◯	◯	◯
The AIFMD objectives correspond to the needs and problems in EU asset management and financial markets	◯	◯	◯	◯	◯	◯
The AIFMD has provided EU AIFs and AIFMs added Value	◯	◯	◯	◯	◯	◯

Question 3.1 Please explain your answer to question 3, providing quantitative and qualitative reasons to substantiate it:

N/A.

Question 7. Is the AIFMD provision providing that it does not apply to employee participation schemes or employee savings schemes effective?

◯ Yes
◯ No
◯ Don't know / no opinion / not relevant

Question 7.1 Please explain your answer to question 7:

Q7: No

Q7.1: Notwithstanding the relevance of such a provision (?), it would seem France is unaware of this provision as almost all its employee savings (either employee stockownership and diversified savings) are held via "FCPEs" which are AIFs. These specific AIFs alone weighted € 145 billion end of 2019.[4] This single evidence by the way make us believe that the overall amount of € 1 trillion of retail AIFs throughout the EU according to ESMA seems very low, also as it does not include the big amount of AIF assets held economically by individual investors via unit-linked products.

Question 20. Can the AIFM passport be improved to enhance cross-border marketing and investor access?

- Yes
- No
- Don't know / no opinion / not relevant

Question 20.1 If so, what specific measures would you suggest?

Please explain your suggestions, presenting benefits and disadvantages as well as potential costs thereof, where possible:

Q20: Yes

Q20.1: The main issue is that the retail marketing and distribution regime for AIFs has been left in full to the power of national competent authorities, which has both created barriers to cross-border distribution and fragmented the AIF market among national lines.

The retail distribution regime for AIFs (Art. 43 AIFMD) should be harmonised at EU level in order to avoid regulatory arbitrage or gold plating.

Investor protection

Question 21. Do you agree that the AIFMD should cross-refer to the client categories as defined in the MIFID II (Article 4(1)(ag) of the AIFMD)?

- Yes
- No
- Don't know / no opinion / not relevant

If no, how could the investor classification under the AIFMD be improved?

Please give examples where possible and present benefits and disadvantages of your suggested approach as well as potential costs of the change:

Q21: Yes.

BETTER FINANCE believes that the MiFID II client categorisation regime should be extended to AIFs as well.

Question 21.1 Please explain your answer to question 21:

[4] BETTER FINANCE Report on the Real Returns of Long-Term and Pension Savings, 2020 edition, French case, p. 210, available at: https://betterfinance.eu/wp-content/uploads/The-Real-Return-Long-Term-Pension-Savings-Report-2020-Edition.pdf.

Although the current classification requires an amendment (see BETTER FINANCE input to the European Commission's 2019 Consultation on MiFID II / MiFIR, https://betterfinance.eu/wp-content/uploads/BETTER-FINANCE-Response-stylised-EC-MiFID-2-review.pdf), it is still a good regime to distinguish between professional and individual, non-professional investors – which triggers an entire suite of investor protection rules.

Question 22. How AIFM access to retail investors can be improved?

Please give examples where possible and present benefits and disadvantages of your suggested approach as well as potential costs of the change:

In several jurisdictions, "access" should not be improved, but rather reformed in order to ensure that AIFs that should not be distributed to non-professional investors (based on the suitability assessment) are not indirectly distributed through master-feeder structures or as part of packaged retail investment products like unit-linked insurance contracts ("IBIPs"); unless such AIFs are subject to UCITIS KIID disclosure rules.

Question 23. Is there a need to structure an AIF under the EU law that could be marketed to retail investors with a passport?

- Yes
- No
- Don't know / no opinion / not relevant

Yes, see answer to Question 20.1 above.

Question 23.1 If yes, what are the requirements that should be imposed on such AIFs?

Please give examples where possible and present benefits and disadvantages of your suggested approach as well as potential costs of the change:

The requirements for the distribution of retail investment products across the EU should be harmonised, and not-product specific. As such, we refer to the requirements imposed by MiFID II and the UCITS V Directive.

Question 23.1 Please explain your answer to question 23:

n/a.

Question 36. Are the mandatory disclosures under the AIFMD sufficient for investors to make informed investment decisions?

- Yes
- No
- Don't know / no opinion / not relevant

The previous general disclosure regime (Art. 23 AIFMD) and, in certain jurisdictions, the UCITS V disclosure regime (the KIID Regulation extended to AIFs as well, as in France, Finland and Denmark) provided more clarity and meaningful information to non-professional investors than the current regime. The new pre-contractual disclosures under PRIIPs worsened the situation of individual investors. Under the AIFMD, the disclosures required from AIF managers (Art. 23) were similar to UCITS and included:

a) A description of the investment strategy and objectives, the type of assets it will invest in and the techniques used (equivalent to Section 1 of the KIID);
b) Description of all fees, charges and expenses and of the maximum amounts thereof to be borne directly/indirectly by investors (similar to Section 3 of the KIID);
c) The historical performance of the AIF (equivalent to Section 4 of the KIID);

Therefore, just as for UCITS, the actual and clear disclosure for investment funds will only be available to those who need it least: professional investors.

Moreover, the only AIFMD-regulated disclosure is the Annual Report (Art. 22). The Prospectus must be published (Art. 23(3) AIFMD) only where Regulation 2017/1129 [Art. 1(2)(a)] or national law require it, meaning that, in most cases, EU individual, non-professional investors will be left only with the PRIIPs KID as pre-contractual disclosure.

Language of disclosures: the AIFMD covers very little in what is retail investor protection; everything not covered by PRIIPs falls therefore under MiFID II.

Question 36.1 If not, what elements of the mandatory disclosures under the AIFMD could be amended?

Please explain your position presenting benefits and disadvantages of the potential changes as well as costs:

Explained in the answer to Question 36 above.

Question 37. What elements of mandatory disclosure requirements, if any, should differ depending on the type of investor?
Please explain your position, presenting benefits and disadvantages of the potential changes as well as costs:

No opinion regarding professional investors. Non-professional qualified clients (in line with the answer to Questions 21 and 21.1 above) could be allowed to opt between the disclosures tailored for professional or for "retail" clients.

Question 38. Are there any additional disclosures that AIFMs could be obliged to make on an interim basis to the investors other than those required in the annual report?

- Yes
- No
- Don't know / no opinion / not relevant

No.

Question 38.1 Please explain your answer to question 38, presenting benefits and disadvantages of the potential changes as well as costs:

N/A.

Question 39. Are the AIFMD rules on conflicts of interest appropriate and proportionate?

- Yes
- No
- Don't know / no opinion / not relevant

Question 39.1 If not, how could the AIFMD rules on conflicts of interest be amended?

Please provide your suggestions, presenting benefits and disadvantages of the potential changes as well as costs:

Yes.

Supervisory reporting

Question 67. Should the supervisory reporting by AIFMs be submitted to a single central authority?

- Yes
- No
- Don't know / no opinion / not relevant

Question 67.1 Please explain your answer to question 67:

Yes, to avoid regulatory arbitrage.

Question 67.1 If yes, which one:

- ESMA
- other options

Please explain your choice, particularly substantiating 'other options', and provide information, where available, on the benefits, disadvantages and costs of implementing each proposition:

ESMA.

Sustainability/ESG

Question 90. The disclosure regulation 2019/2088 defines sustainability risks, and allows their disclosures either in quantitative or qualitative terms.

Should AIFMs only quantify such risks?

- Yes
- No
- Don't know / no opinion / not relevant

Question 90.1 Please substantiate your answer to question 90, also in terms of benefits, disadvantages and costs as well as in terms of available data:

No.

BETTER FINANCE agrees with the quantitative indicators that would allow for a better standardisation and harmonization of the information disclosed. However, we stress the need to provide understandable information to individual investors. Disclosure for individual investors must be at all times simple, short and concise, avoiding jargon and comparable. To be simple, short and concise, it must focus only on key elements that can and should guide the financial decision making of the average investor. To be comparable, it must reach the highest degree of standardisation at cross-sectoral levels and standardisation concerns not only the type of information to be included, but also the order of sections and format; in other words, it must exhibit the same structure.

Where necessary qualitative disclosure should be in place when required to assess the adverse impact.

Question 91. Should investment decision processes of any AIFM integrate the assessment of non-financial materiality, i.e. potential principal adverse sustainability impacts?

- Yes
- No
- Don't know / no opinion / not relevant

Yes

Question 91.1 Please substantiate your answer to question 91, also in terms of benefits, disadvantages and costs. Please make a distinction between adverse impacts and principal adverse impacts and consider those types of adverse impacts for which data and methodologies are available as well as those where the competence is nascent or evolving:

Clear definition of principal adverse impact needs to be provided. In addition to indicator and metrics for principal adverse impact a clear definition needs to be included in order to guarantee that financial market participants will use the same language and will have the same understanding of the concept. At the moment, the regulation fails to provide such a clear definition. The concept of materiality needs to be in line with non-financial reporting directive. As previously advocated by BETTER FINANCE in the consultation on the non-financial reporting directive materiality needs to be assessed according to 2 dimensions (double materiality):

1. the potential and/or the actual impact of sustainability risks on the performance, reputation and activities of the companies over the short and long-term (this includes also the financial materiality of the company).
2. the potential and/or actual impact of sustainability risks outside the company (that includes the environment, society, communities etc.,) over the short and long-term.

Therefore, the disclosure process should be based on a double materiality assessment based on a clear definition of these 2 aspects. In the long term, ESG risks and opportunities can become financially material, and therefore should be integrated in financial decision-making. Public reporting of non-financial information enables investors/shareholders to gather public support for the issues at stake and make their case for engagement with corporate boards/ filing an ESG-related shareholder resolution. Public disclosure of potential impacts of sustainability risks/opportunities allows shareholders to make their own assessment as to their financial materiality. This is why the disclosure regulation needs to be consistent and linked with the non-financial reporting directive in particular regarding the definition of principal adverse impact indicators.

Question 92. Should the adverse impacts on sustainability factors be integrated in the quantification of sustainability risks (see the example in the introduction)?

- Fully agree
- Somewhat agree
- Neutral
- Somewhat disagree
- Fully disagree
- Don't know / no opinion / not relevant

Question 92.1 If you agree, please explain how and at which level the adverse impacts on sustainability factors should be integrated in the quantification of sustainability risks (AIFM or financial product level etc.).

Please explain your answer including concrete proposals, if any, and costs, advantages and disadvantages associated therewith. Please make a distinction between adverse impacts and principal adverse impacts and consider those types of adverse impacts for which data and methodologies are available as well as those where the competence is nascent or evolving

Fully agree.

Question 92.1 Please explain your answer to question 92:

We believe that the indicators on the reporting template provided in Table 1 of Annex I of the ESAs proposal on the Regulatory Technical Standards (RTS of the disclosure regulation)[5] would need more explanations on the type of information and data they require. It is important that the list of indicators does not end up as a mere tick the box exercise. The indicators should provide an overview of the goals also in relation to the engagement policy. The principle adverse impact should be assessed against targets/goals of the investment portfolio. Therefore, a stronger link between the engagement policy and adverse impact targets should be done.

Question 93. Should AIFMs, when considering investment decisions, be required to take account of sustainability-related impacts beyond what is currently required by the EU law (such as environmental pollution and degradation, climate change, social impacts, human rights violations) alongside the interests and preferences of investors?

- Yes
- No
- No, ESMA's current competences and powers are sufficient
- Don't know / no opinion / not relevant

Question 93.1 If so, how should AIFMs be required to take account of the long-term sustainability and social impacts of their investment decisions?

Please explain.

Q93: Yes

[5] https://www.esma.europa.eu/sites/default/files/jc_2020_16_-_joint_consultation_paper_on_esg_disclosures.pdf

Q93.1: We believe that additional measures relative to the EU 2030 climate and energy targets and measures of carbon emissions relative to the prevailing carbon price would provide additional disclosure on portfolio alignment to science based international climate objectives. As several methodologies currently exist on measuring company and portfolio temperatures, it is necessary to streamline and harmonize the metrics in accordance with the non-financial reporting directive (NFRD) and the Taxonomy regulation.

Question 94. The EU Taxonomy Regulation 2020/852 provides a framework for identifying economic activities that are in fact sustainable in order to establish a common understanding for market participants and prevent green-washing. To qualify as sustainable, an activity needs to make a substantial contribution to one of six environmental objectives, do no significant harm to any of the other five, and meet certain social minimum standards. In your view, should the EU Taxonomy play a role when AIFMs are making investment decisions, in particular regarding sustainability factors?

- Yes
- No
- Don't know / no opinion / not relevant

Question 94.1 Please explain your answer to question 94:

Yes

The disclosure regulation needs to be harmonised with the taxonomy regulation and the non-financial reporting directive. Considering that one of the major issues is the lack of a common definition of sustainable investments, it necessary to link how asset managers define sustainable investments with the taxonomy-compliant activities in order to avoid any regulatory divergences. In this regard, we advise to strengthen this link in the draft of Regulatory Technical Standards (RTS).

Question 95. Should other sustainability-related requirements or international principles beyond those laid down in Regulation (EU) 2020/852 be considered by AIFMs when making investment decisions?

- Yes
- No
- Don't know / no opinion / not relevant

Question 95.1 Please explain your answer to question 95, describing sustainability-related requirements or international principles that you would propose to consider.

Please indicate, where possible, costs, advantages and disadvantages associated therewith:

Q95: Yes

Q95.1: We believe that additional measures relative to the EU 2030 climate and energy targets and measures of carbon emissions relative to the prevailing carbon price would provide additional disclosure on portfolio alignment to science based international climate objectives. As several methodologies currently exist on measuring company and portfolio temperatures, it is necessary to streamline and harmonize the metrics in accordance with the non-financial reporting directive (NFRD) and the Taxonomy regulation.

Miscellaneous

Question 101. Should the UCITS and AIFM regulatory frameworks be merged into a single EU rulebook?

- Yes
- No
- Don't know / no opinion / not relevant

Question 101.1 Please explain your answer to question 101, in terms of costs, benefits and disadvantages:

Yes, for legal clarity and certainty and to avoid the "silo" approach currently describing EU financial law.