Five things you need to know about investment funds in 2022

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In the field of investment funds, we have identified the following five trends, which will shape your agenda in the coming year. By anticipating these developments, you can use them to your advantage and prepare for their impact. The five main trends are:
1. Increased importance of ESG
2. Retailisation of alternative investment funds
3. Investment by funds in virtual assets
4. Upcoming amendments to AIFMD
5. Upcoming amendments to the ELTIF Regulation

Trend #1 – Increased importance of ESG > Adoption of delegated acts and RTS

The Climate Delegated Act was formally adopted on 4 June 2021 and establishes technical screening criteria to determine when an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation, within the meaning of Article 9 of the Taxonomy Regulation, and causes no significant harm to other environmental objectives. It applies to companies subject to the obligation to publish non-financial statements in accordance with the Non-financial Reporting Directive («NFRD»), which lays down rules on the disclosure of non-financial and diversity information by large financial and non-financial companies. The Climate Delegated Act was published in the *Official Journal* of the EU on 9 December 2021 and has been applicable since 1 January 2022.

An additional act supplementing Article 8 of the Taxonomy Regulation (the «Disclosure Delegated Act») was adopted on 6 July 2021. The Disclosure Delegated Act sets out the content, methodology and presentation of the key performance indicators («KPIs») that non-financial and financial undertakings are required to disclose under Article 8 of the Taxonomy Regulation. The Disclosure Delegated Act was published in the *Official Journal* on 10 December 2021 and entered into force on 30 December 2021. It has been applicable since 1 January 2022, on a phased basis.

A second delegated act on technical screening criteria, for economic activities that contribute significantly to the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control, or the protection and restoration of biodiversity and ecosystems (known as the «Environmental Delegated Act»), is currently being prepared and is expected to be published in the course of 2022.

Finally, the first quarter of 2022 should see the formal adoption of regulatory technical standards («RTS») by the European Commission (the «Commission»), with a foreseen application date of 1 January 2023.

Trend #2 – Retailisation of alternative investment funds > Expansion of the investor base

The retailisation of alternative investment funds is an incontrovertible trend, driven by an expectation of higher returns through exposure to non-traditional asset classes and a desire on the part of alternative asset managers («AIFMs») to widen their investor base in order to obtain additional funding for the vehicles they manage. For retail investors, however, barriers to investment in such funds still exist, such as lack of liquidity, high minimum investment thresholds, irregular capital calls to be satisfied at relatively short notice, and the long-term nature of the investments.

Nonetheless, the EU legislature is actively considering how more funding can be channelled, including from retail investors, into the real economy. This approach is reflected in the recently proposed amendments to the European Long-term Investment Funds («ELTIF») Regulation, discussed below. One possible solution is to set up a feeder fund to pool the contributions of retail investors in a separate vehicle. The feeder fund then invests in a master fund, together with institutional and professional investors. This type of master-feeder structure can help to assuage the liquidity concerns of retail investors as additional liquidity in the feeder fund can be ensured through enhanced redemption options or the facilitation of secondary transfers. In this context, it should be noted that the Regulation on European Crowdfunding Service Providers, which entered into force on 10 November 2021, aims to extend access to financing, including from retail investors, for start-ups and SMEs.

Trend #3 - Investment by funds in virtual assets > Authorisation extension and compliance requirements

The launch of the first fund formed under Luxembourg law specifically for investment in cryptocurrencies, digital assets, and funds and equity of fintech or blockchain-linked companies has focused attention on crypto asset investment opportunities. The CSSF recently pointed out that virtual assets are not available to all investors or suitable for all investment objectives as they do not constitute eligible assets for undertakings for collective investment in transferable securities («UCITS») or UCIS open to non-professional investors and pension funds (except for assets qualifying as financial instruments). On the other hand, virtual assets can be suitable for alternative investment funds («AIFs») marketed to professional investors and managed by an AIFM, which has obtained a specific extension of its authorisation to engage in this type of investment strategy. In addition to an authorisation extension, AIFMs and service providers will need to reshape their business model, governance, organisational policies, and risk assessment and procedures in order to comply with the CSSF's best practices for such risk-sensitive asset classes.

From a regulatory standpoint, the upcoming EU Regulation on Markets in Crypto Assets («MiCA») aims to limit the risks of fraud and illicit practices on crypto markets by imposing compliance requirements on service providers and to address potential financial stability and monetary policy risks that could arise from the mass adoption of crypto assets considered asset-referenced tokens or e-money tokens, depending on their structure.

Trend #4 – Upcoming amendments to AIFMD > Improvements to the AIFMD framework

On 25 November 2021, the Commission released a proposal to amend the Alternative Investment Fund Managers Directive («AIFMD»). The main amendments regard delegation arrangements, liquidity risk management, supervisory reporting, and the provision of depositary and custody services and loan origination by alternative investment funds («AIFs»). The Commission believes that a number of issues highlighted in its AIFMD review are also relevant for the activities of UCITS. Consequently, the proposal aims to address these issues by amending both AIFMD and the UCITS Directive to better align their requirements.

The Commission recognises the value of the delegation regime, which allows for the efficient management of investment portfolios. Amendments are however proposed to ensure that AIF managers retain core functions. The proposal introduces Annex V to AIFMD, which includes a list of liquidity management tools («LMT») available to AIFMs of open-ended AIFs. In order to enable the managers of open-ended AIFs to deal with redemption pressure under stressed market conditions, they should be required to choose at least one LMT from the list, in addition to the possibility of suspending redemptions. The Commission further concluded that there is a need to harmonise the rules for managers of loan-originating AIFs. The amended directive is expected to be adopted in early 2023. Member States will then have 24 months to amend their national legislation accordingly.

Trend #5 - Upcoming amendments to the ELTIF Regulation > Increase in the use of ELTIFs across the EU

The European long-term investment fund («ELTIF») is an alternative investment fund for long-term investments, such as social and transport infrastructure projects, real estate and SMEs. The ELTIF regulatory framework is intended to facilitate long-term investment in these types of assets by institutional and retail investors and provide an alternative, non-bank source of financing for the real economy. Given their overlap, the Commission is reviewing AIFMD and the ELTIF Regulation at the same time. The proposed amendments to the latter aim to increase the uptake of ELTIFs across the EU for the benefit of the European economy and investors. This means in particular broadening the scope of eligible assets and investments, allowing more flexible fund rules that include the facilitation of fund-of-fund strategies, and reducing unjustified barriers that prevent retail investors from accessing ELTIFs.

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