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Regulatory changes affecting microfinance investment vehicles: threats or opportunities?

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Agenda

The regulatory landscape of european investment funds is evolving fast and on many different aspects. The panel proposes to explore what this all means for microfinance investment vehicles and to identify where the challenges, opportunities and next trends are: Impact management and compliance with SFDR, AIFMD 2.0 and the future of debt funds, distribution towards retail investors: securitisation and other products.



The scale of the regulatory changes in recent years: Regulatory initiatives in sustainable finance

Number of regulatory developments in 45 countries and EU:



+ 750

In the past five years, regulatory developments increased by:



+ 250%

Number of consultation processes held:



60

Compared to 2020, regulatory developments in EU increased in 2021 by:



+ 130%

Top 5 trending topics in 2017-2021:

2017	2018	2019	2020	2021
Transparency	Responsible investment	Climate change	Climate change	ESG integration
Corporate social responsibility	Climate change	Environmental risks	Environmental risks	Environmental risks
Human rights	Fiduciary duties	Transparency	Scope 3 GHG	Climate change
Reporting	Environmental risks	Fiduciary duties	Emission Trading Systems	Scope 3 GHG
ESG integration	Product labeling	Responsible investment	Biodiversity	Biodiversity

Source: ECO:FACT Regulatory Outlook, October 2021, <https://www.ecofact.com/de/policyoutlook/>. The Outlook covers 31 regulatory topics pertaining to sustainable finance and corporate responsibility in over 45 countries and the EU.

EU Taxonomy (Regulation (EU) 2020/852)



A list of economic activities that are considered (environmentally & socially) **sustainable** for investment purposes considering specific criteria



It is not:

- A rating of “good” or “bad” companies
- A mandatory list in which to invest



Aims at providing a tool to help investors, companies, issuers and project promoters to classify sustainable investments and ultimately **redirect capital flows towards more sustainable business activities**



Implementation status:

- Environmental Taxonomy: Climate change objectives adopted
- Social Taxonomy: Final report published



Considers 3 pillars / levels of criteria to demonstrate alignment:



Environmental Taxonomy Objectives



CLIMATE CHANGE
MITIGATION



CLIMATE CHANGE
ADAPTATION



POLLUTION
PREVENTION



CIRCULAR
ECONOMY



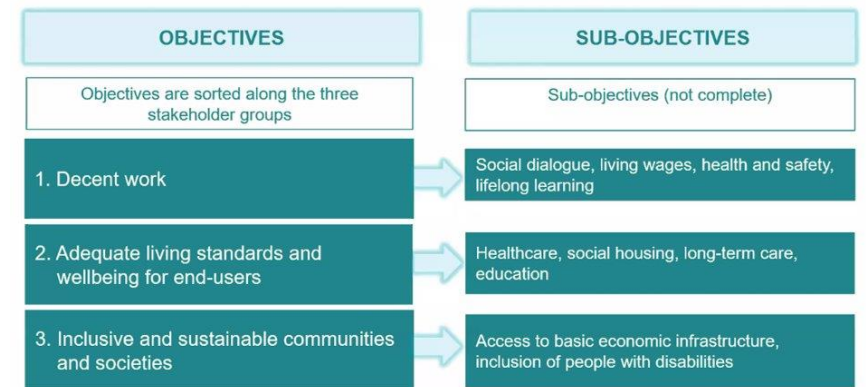
SUSTAINABLE USE OF WATER AND
MARINE RESOURCES



HEALTHY
ECOSYSTEM

* To date, final technical screening criteria adopted for two of the objectives, draft published for other four.

Social Taxonomy (under development)



Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088, SFDR)



- A set of standards for financial market participants and financial advisers to **incorporate ESG risks and factors** in decision-making and investment advice
- Requires series of **sustainability-related disclosures** which must be made in precontractual documentation, annual reports, and on websites
- **First disclosure requirements came into force in March 2021**, with further requirements forthcoming in 2023



Aims at **facilitating transparency** in the financial services sector by providing information to investors on the integration of **sustainability risks, consideration of adverse sustainability impacts, attainment of sustainable investment objectives** in investment decision-making and in advisory processes



Regulatory Technical Standards (RTS) specify presentation and content details with regards to product-level disclosures related to consideration of the adverse sustainability impacts, sustainable investment objective, Taxonomy-related disclosures

Principle Adverse Impacts (PAI)
Impact management and measurement

Types of products under SFDR

Article 6: No integration of sustainability in investment process

No integration of sustainability into investment process; ESG factors not included.

Article 8: Financial products that promote environmental and/or social characteristics

1. Promotion of, among others, environmental or social characteristics, or a combination of those characteristics
2. Investee companies follow good governance practices

Article 9: Financial products (e.g. MF funds) that have sustainable investment as key objective

1. Contribution to an environmental or social objective
2. Investment does not significantly harm any of those objectives
3. Investee companies follow good governance practices



and many others ...

Greater/deeper disclosure requirements

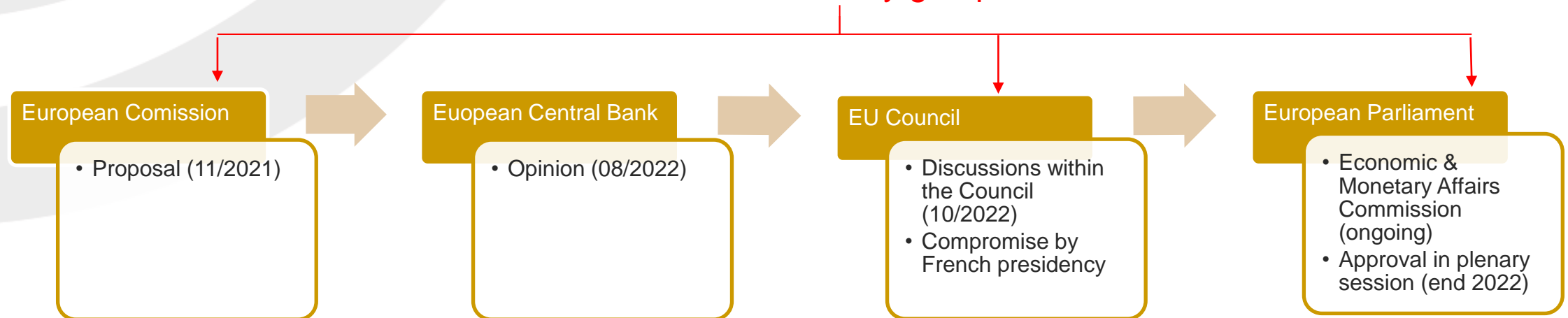
Amending Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD 2)

- ❑ AIFMD regulates i.a. fund managers of private equity and private debt impact funds in the EU.
- ❑ In November 2021, EU Commission initiated amendment to the 10-year old AIFM Directive (2011). AIFMD 2 proposes to introduce new rules for loan-originating alternative investment funds (“AIFs”)
- ❑ The proposal includes a new art. 16 (2a) stipulating that **‘open-ended’ AIFs are no longer allowed if notional value of originated loans exceeds 60% of the fund’s NAV**. Rationale:
 - ❑ Concerns about maturity mismatch
 - ❑ Moral hazard situation (sale of loans to secondary market)
 - ❑ Stability of the EU financial system
 - ❑ → Fight against shadow banking and lack of level playing field with regulated Fis
- ❑ A substantial portion of private debt impact funds are ‘open-ended’ and would be affected by this detrimental proposal. The three elements of the rationale do not apply to debt impact funds.

The process of the amendment and how we have tried to influence

- ❑ Interventions at national levels and EU Permanent Representations in 12/2021 (Belgium; the Netherlands)
- ❑ 9 Debt Impact Investment Funds (DIIFs) transmitted a position paper to the Commission and the French Presidency proposing the amendment of art 16 (2a): deleting the 60% rule but including rules about liquidity management tools addressing micro- and macro prudential risks (02/2022)
- ❑ We understand from informal sources that the French Presidency of the EU Council proposed compromise: 60% rule is deleted but ESMA must impose proper risk mg't tools
- ❑ We understand from informal sources that certain MEPs within the Economic and Monetary Affairs Commission of the EP reconsider introducing the 60% rule

Interventions by group of DIIFs



Conclusion: Outcome very unclear – Serious risks for European impact industry

- ❑ European impact fund industry faces difficulties in explaining EU authorities the importance of the impact fund industry, in particular ‘open-ended’ debt funds
- ❑ European impact fund industry is not well equipped for efficient lobbying
- ❑ EU pushes impact fund managers to use ELTIF funds (closed-ended). However, the instrument has serious shortcomings (even new ELTIF Regulation ELTIF 2)

Retailisation of funds – 1/3

1 ELTIF:

- Current regime: possible distribution to retail investors:
 - Investors with portfolio of financial instruments in excess of EUR 500,000 OR
 - Investors with a portfolio of financial instruments below EUR 500,000 if:
 - In excess of EUR 100,000;
 - Minimum investment of EUR 10,000; and
 - Maximum 10% of financial instruments invested in ELTIFs
- **ELTIFR Reform:**
 - Suitability test
 - Removal of requirement to invest minimum EUR 10,000
 - Removal of requirement to invest maximum 10% of the investor's financial instruments

2

Securitisation / Prospectus Regulation:

- New Securitisation regime in Luxembourg
- Prospectus Law: obligation to publish a prospectus does not apply to:
 - an offer of securities addressed solely to qualified investors (as defined by the Prospectus Law),
 - an offer of securities addressed to fewer than 150 natural or legal persons, other than qualified investors, per Member State
 - an offer of securities addressed to investors that acquire securities for a total consideration of at least EUR 100,000 per investor and for each separate offer
 - an offer of securities whose denomination per unit amounts to at least EUR 100,000; and/or
 - an offer of securities with a total consideration of less than EUR 8,000,000, which shall be calculated over a period of 12 months.

Retailisation of funds – 2/3

3 AIFMD:

- Broadening of marketing to certain non-professional investors:
 - Art. 32 AIFMD
 - Only certain countries extend AIFMD marketing passport to certain non-professional investors (e.g. Austria, Denmark, Germany)
- Art. 43 AIFMD:
 - Subject to each EEA country's own local requirements (e.g. impossible in France)
 - Luxembourg: Part II UCI
- AIFMD II: broadening of definition of « professional investor »:
 - Addition to the MiFID definition
 - Min. EUR 100,000 investment + written statement of awareness of the associated risk

4 Crowdfunding Regulation:

- Regulation (EU) 2020/1503 only applies to crowdfunding services provided to non-consumer project owners relating to offers for an amount of up to EUR 5,000,000 calculated over a period of 12 months per project owner
- Prior authorisation as crowdfunding service provider
- Possible cross-border provision of crowdfunding services
- Investor protection:
 - Entry knowledge test and simulation of the ability to bear loss for non-sophisticated investors
 - Pre-contractual reflection period (4 calendar days)
 - Key investment information sheet

Retailisation of funds – 3/3

ELTIF



- Providing retail investors with exposure to non-traditional asset classes
- Reform will provide higher flexibility
- Investor protection



- No financial undertakings
- Heavily regulated
- Tax incentives
- Restriction for emerging markets

**Securitisation
Prospectus Regulation**



- Costs
- Flexibility
- Active management of debt portfolio



- No investment strategy
- Reputation

AIFMD



- Opening access to alternative assets for retail investors
- Increased flexibility



- Extension of passport on a country-by-country basis
- Fragmented NPPR regimes
- Dichotomy with MiFID definition

**Crowdfunding
Regulation**



- Increased exposure
- Low overall financial risk
- Democratisation of access to finance



- Investor protection requirements
- Authorisation process
- Maximum amount per project owner



Any questions?

Thank you!