

A brief guide to marketing investment funds in the EU

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INTRODUCTION

The European Union (EU) is an economic and political union comprising 28 independent member states. The EU marketplace has a combined population of over 500 million (7.3% of the world's population) and is of huge significance to the investment fund industry across the spectrum from asset management and service provision to consumer, both retail and institutional.

However, access to the EU marketplace is not necessarily straightforward. At the time of writing, three different investment fund regimes exist:

- **The undertakings for collective investment in transferable securities regime (UCITS regime).** This regime relates to undertakings for collective investment in transferable securities (UCITS) funds in the EU single market (*see below, UCITS regime*).
- **The alternative investment fund managers Directive regime (AIFMD regime).** This regime also relates to the EU single market, but relates to alternative investment fund managers (AIFMs) managing alternative investment funds (AIFs) within the EU (*see below, AIFMD regime*).
- **National private placement rules (NPPR).** This regime imposes rules at EU level, but also allows individual member states to impose their own requirements on any sale within their own border (*see below, National private placement rules*).

This article will briefly explain:

- The three main investment fund regimes currently operating in the EU.
- The types of funds applicable to each regime.
- The type of investors likely to be targeted in each of the three regimes.

Since the UCITS regime and the AIFMD regime for EU AIFMs and their EU AIFs are relatively straightforward, more attention has been given to the NPPR regime. To illustrate how the NPPR regime works, this article will provide a brief comparison of the national private placement rules in the United Kingdom and France to show how the national regulators in these two key EU markets have taken very different approaches to NPPR (*see below, United Kingdom and France*).

UCITS REGIME

UCITS are collective investment schemes established and authorised under a harmonised EU legal framework. Under this framework, UCITS established and authorised in one EU member state can be sold across the border into other EU member states without the requirement for additional authorisation.

The UCITS regime was first introduced in Europe over 20 years ago, to provide a harmonised retail fund regime suitable for sale to the retail market within the EU on a cross-border basis. In the

intervening period, both the UCITS product itself and the mechanism for selling UCITS have been enhanced significantly. This has allowed for a wide variety of investment strategies within the UCITS framework, all of which are subject to UCITS product rules that can be implemented, with the help of the European Securities and Markets Authority (ESMA), in a uniform manner across each of the EU member states.

The current EU legislation for UCITS is Directive 2009/65/EC on undertakings for collective investment in transferable securities (UCITS IV Directive). The UCITS V Directive, which will enhance the existing regime, was published on 28 August 2014 in the Official Journal of the EU (OJ) and must be transposed into national law of member states by 18 March 2016. UCITS V focuses on three main areas, namely:

- Clarification of the UCITS depositary's eligibility, its functions and its liability in circumstances where assets in custody are lost.
- Rules governing remuneration policies.
- The harmonisation of the minimum administrative sanctions regime across member states.

European passport

The "European passport" is central to the UCITS product, as it enables fund promoters to create a single product for the entire EU rather than having to establish an investment fund product on a jurisdiction-specific basis. Therefore, on the completion of the appropriate notification procedure, a UCITS established in one member state can be sold in any other member state without the need for additional authorisation.

Notification procedure

Since the implementation of UCITS IV, the notification procedure for cross-border distributions of UCITS has been reduced to a simple electronic regulator-to-regulator communication, with the distribution of the UCITS immediately permissible after such communication. The form and content of the notification is set out in the relevant legislation and comprises the following documents (collectively known as the "Notification File"):

- Standard model notification letter and accompanying documentation completed by the UCITS.
- Standard model attestation completed by the regulator in the UCITS home member state (the home regulator).

A UCITS intending to market in another member state must complete and submit to its home regulator, via a designated email address, a standard model notification letter outlining details with respect to the UCITS. The standard model notification letter must include the following details:

- Its legal form.
- Its management company (where applicable).

- The arrangements made for marketing the UCITS in the host member state.
- The arrangements made for the provision of payment facilities to unitholders in the host member state.
- The arrangement made to make the information available to the unitholders (required under the UCITS IV Directive).

The following must be attached to the notification letter, together with a link to indicate where the latest electronic copy of these documents can be obtained in the future:

- The latest versions of the UCITS' constitutional documents.
- Prospectus.
- Key investor information document (KIID).
- Annual report and any subsequent half yearly report.

Within ten days of receipt of the notification letter from the UCITS, the home regulator must complete a standard model attestation setting out:

- The date of establishment of the UCITS.
- Its legal form.
- The list of sub-funds currently approved by the home regulator.
- Confirmation that the UCITS fulfils the conditions set out in the UCITS IV Directive.

The completed Notification File must then be submitted to the regulator in the member state in which it proposes to market the UCITS (the host regulator) via an email address designated by the host regulator.

Following the successful transmission of the Notification File, the home regulator must immediately notify the UCITS and from this date, the UCITS will be able to access the market of the host regulator.

The only document which requires translation in the language of the host member state is the KIID. The decision to translate the other fund documents will depend on the conditions of the UCITS itself.

AIFMD REGIME

Directive 2011/61/EU on alternative investment fund managers (AIFM Directive) is intended to create a comprehensive and effective regulatory and supervisory framework for AIFMs at European level and open up the EU as a single market place for alternative funds (such as hedge funds, private equity funds, real estate funds or other structures unable to fit within the UCITS regime due to liquidity or portfolio concentration issues).

Marketing passport

For the first time, the AIFM Directive creates a single marketplace within the EU for the marketing of AIFs, known as a marketing "passport". Prior to the AIFM Directive, such marketing was only available to UCITS funds.

However, initially (at least until October 2015) only entities established in the EU can be authorised as AIFMs to obtain the marketing passport for their EU-domiciled AIFs.

Under the AIFM Directive, the activity of marketing includes "any direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM, of units or shares in a fund it manages to or with investors domiciled in the EU".

This definition does not include reverse solicitation, which should be considered to be outside the scope of the AIFM Directive.

Although the definition of marketing in the AIFM Directive is extremely broad, no further guidance on the concept is provided by the Directive, leaving the definition open to interpretation in the various EU member states. As at the date of this article, most

member states have chosen not to provide a more specific definition of marketing. However, in the UK, the Financial Conduct Authority (FCA) has provided some guidance on the issue, stating that marketing will occur when:

"a person seeks to raise capital by making a unit of share of an AIF available for purchase by a potential investor. This includes situations which constitute a contractual offer that can be accepted by a potential investor in order to make the investment and form a binding contract, and situations which constitute an invitation to the investor to make an offer to subscribe for the investment" (*FCA Handbook*).

In addition to managers based in the EU, the AIFM Directive applies to any non-EU based fund manager (including, for example, fund managers based in the US or Asia) who:

- Manages one or more AIFs domiciled in the EU.
- Markets AIFs to investors in the EU (irrespective of the AIF's domicile).

For example, a US-based fund manager that manages Cayman-based offshore funds that are marketed to EU investors in a master-feeder structure would typically fall within the scope of the AIFM Directive.

Initially (at least until October 2015), only entities established in the EU can be authorised as AIFMs to obtain the marketing passport for their EU domiciled AIFs. From October 2015, the European Commission may decide to "switch on" certain provisions of the AIFM Directive, which will enable a non-EU based manager to apply to become authorised as an AIFM under the AIFM Directive and market its funds in the EU under the marketing passport.

By 22 July 2015, ESMA has to submit to the European Commission an opinion ("ESMA Opinion") on the functioning of the EU Passport under the AIFMD and the functioning of the marketing of non-EU AIFs by EU AIFMs in the EU and the management and/or marketing of AIFs by non-EU AIFMs in the EU. ESMA must also issue advice on whether the passporting regime should be extended to the management and/or marketing of AIFs by non-EU AIFMs and to the marketing of non-EU AIFs by EU AIFMs. Within three months (that is, October 2015) of receipt of positive advice and an opinion from ESMA, and taking into account the criteria and objectives of the AIFMD, the Commission must adopt a delegated act specifying the date when the EU passport would be extended to non-EU AIFs and non-EU AIFMs. It is worth bearing in mind however, that ESMA's advice will not treat all non-EU countries as a single block. The advice will distinguish between non-EU countries so that only the AIFs or AIFMs of those countries that meet relevant criteria set out in AIFMD will benefit from extension of the passport.

However, until this time, managers based outside the EU can continue to market in an EU member state without the marketing passport, provided the marketing is subject to:

- The EU member state's own NPPRs.
- "Transparency Rules" imposed by the AIFM Directive (*see below, The Transparency Rules*).

The NPPRs (if any) will continue to be in place until at least 2018.

EU-based AIFMs with AIFs inside the EU: notification procedure

From 22 July 2013, subject to a straightforward notification process, EU-authorized AIFMs have a passport to freely market EU-domiciled AIFs to professional investors (that is, investors considered to be professional clients or treated as professional clients on request, within the meaning of Annex II of Directive 2004/39/EC on markets in financial instruments (MiFID)) in both its own member state and other EU member states.

Once the AIFM is authorised in one EU member state, it does not require further authorisation in any other EU member state to market its EU AIFs to professional investors in other member states. Unlike UCITS, the passport does not attach to the AIF and is instead granted to the AIFM.

An AIFM established in an EU member state and authorised by the competent regulatory authority in that member state has the right under the AIFM Directive to both:

- Market shares of an EU AIF that it manages to professional investors in the AIFM's home member state (subject to providing a prescribed Notification File to its home EU member state regulator).
- Market shares of an EU AIF that it manages to professional investors in another EU member state (subject to providing a prescribed Notification File to its home EU member state regulator (the marketing passport)).

The home EU member state regulator can only prevent the marketing of shares in EU AIFs if the information in the notification shows that the AIF concerned will not be managed in accordance with the AIFM Directive. If the EU AIF is a feeder AIF (*see box, Feeder AIF*) the right to market the fund is subject to the condition that the master AIF is also an EU AIF and is managed by an authorised AIFM.

Marketing to retail investors

Individual member states may also allow the marketing of AIFs to retail investors within their own territories. In this regard, individual member states may impose stricter requirements on the AIF or AIFM than the requirements set out in the AIFM Directive.

EU-based AIFMs with AIFs outside the EU: notification procedure

Under the AIFM Directive, each EU member state can allow an authorised EU AIFM to market a non-EU AIF to professional investors in that EU member state under that EU member state's own NPPRs, without a passport, provided:

- The AIFM complies with basic depositary and custody requirements under the AIFM Directive (such as the safe keeping of assets and the supervision of administrative functions).
- There is a co-operation arrangement for the purpose of systemic risk oversight between the regulator of the AIFM's home member state and the supervisory authority of the non-EU country where the AIF is established.
- The non-EU country where the AIF is established is not listed as a non-co-operative country and territory by the Financial Action Task Force on anti-money laundering and terrorist financing.

As mentioned above, subject to the provisions of the ESMA Opinion in July 2015 and following the Commission adopting a delegated act, it is envisaged that certain provisions of the AIFM Directive will be "switched on" in order to allow for EU AIFMs to apply for a passport for their non-EU AIFs. The AIFM Directive also envisages that three years after the European passport becomes available to EU AIFMs of non-EU AIFs, ESMA will issue a further opinion on the continuation of the NPPR regime in the EU. Subject to the provisions of this advice, it is envisaged that:

- The EU will adopt rules to terminate the NPPRs as a means of access to the EU.
- The European passport will become the sole and mandatory regime applicable in all member states.

AIFMs based outside the EU with AIFs based outside the EU: notification procedure

Under the AIFM Directive, each EU member state can allow non-EU AIFMs to market a non-EU AIF to professional investors in that member state under that member state's own NPPRs (that is, without a passport) provided:

- The AIFM complies with the Transparency Rules (*Articles 22 to 24, AIFM Directive*) (*see below, The Transparency Rules*) in respect of each AIF marketed by the AIFM and (where applicable) with certain additional rules relating to acquiring control of non-listed entities.
- There is a co-operation arrangement for the purpose of systemic risk oversight between the regulator of the EU member state where the AIF is marketed, the supervisory authorities of the non-EU country where the non-EU AIFM is established and the supervisory authority of the third country where the AIF is established.
- The non-EU country where the AIF is established is not listed as a non-co-operative country and territory by the FATF.

The advice from the ESMA to be issued in 2015 in respect of the extension of the EU passport to EU AIFMs of non-EU AIFs are also envisaged to cover non-EU AIFMs and their non-EU AIFs. Subject to the provisions of this advice, it is envisaged that certain provisions of the AIFM Directive will then be "switched on" to allow for non-EU AIFMs to apply for authorisation under the Directive, enabling them access to a European passport.

The Transparency Rules

The Transparency Rules impose specific obligations on AIFMs applicable to AIFs marketed in the EU:

- Annual report disclosure requirements.
- Disclosure to investors.
- Periodic reporting to competent authorities.

Annual report. The annual report to be provided to investors must comply with disclosure requirements, which will generally be familiar to fund managers. However, AIFMs will also be required to include additional disclosures including:

- Any material changes during the financial year.
- The total amount of remuneration paid to AIFM staff for the financial year (fixed and variable) number of beneficiaries, and any carried interest.
- The aggregate remuneration (broken down by senior management and staff of the AIFM whose actions have a material impact on risk profile of the AIF).

Disclosure to investors. AIFMs must now disclose general information to investors relating to the:

- Financial and non-financial criteria of the remuneration policies.
- Practices for relevant categories of staff to enable investors to assess the incentives created.

The requirements in relation to the type of information to be made available to investors will also be familiar to investment fund managers. However, certain requirements, including the following, will be new:

- Disclosure on cover for professional liability risks.
- Details of any preferential treatment of investors, the type of investors who obtain such preferential treatment and their legal or economic links with AIF or AIFM.
- The percentage of AIF assets subject to special arrangements due to their illiquid nature and details of the special arrangements.
- Any changes to the maximum leverage that the AIFM may employ on behalf of the AIF, as well as any right of the reuse of collateral or any guarantee granted under the leveraging arrangement.

Reporting to competent authorities. AIFMs are also now required to provide certain information on a regular basis to the supervisors of the member state in which each AIF is marketed. The reporting

must be in template format and include (*Annex IV of the Commission Delegated Regulation No. 231/2013 of 19 December, 2012*):

- The principal markets and instruments traded by it on behalf of the AIF.
- The percentage of AIF assets subject to special arrangements arising from their illiquid nature, arrangements for managing liquidity, the risk management systems employed, the current risk profile of the fund, the main categories of assets invested in, and the results of stress tests performed in line with the AIFM Directive.
- An annual report of the AIF and on request, a list of all funds managed by the AIFM for the end of each quarter.
- Where substantial leverage is employed, information on the overall level of leverage employed.

NATIONAL PRIVATE PLACEMENT RULES

Under the AIFM Directive, member states have discretion (until at least 2018 and subject to the ESMA Opinion) to allow for the marketing of non-EU AIFs marketed by EU AIFMs and AIFs marketed by non-EU AIFMs on a private placement basis.

Countries that intend to allow private placement must apply the minimum AIFM Directive standards to AIFMs marketing under the regime (*see above, AIFMD regime*). In addition to the standard AIFM Directive requirements, each EU member state can impose its own additional NPPRs in relation to the marketing of the product.

If an investment fund intends to access an EU market through private placement, the fund manager should be familiar and compliant with the relevant NPPRs of the member state. In addition, considering the broad level of discretion given to individual member states and the wide variety of applicable rules in each jurisdiction, the fund manager should consult legal counsel in the relevant member state before approaching investors.

An overview of the NPPRs for each EU member state is outside the scope of this article. However, to provide an indication of how the rules can vary from state to state, a brief summary of the applicable NPPRs in the United Kingdom and France are set out below. These two member states have taken very different approaches to the implementation of NPPRs.

United Kingdom

Marketing. In the UK, the FCA has provided broad guidance on the definition of marketing (*see above, AIFMD regime, Marketing passport*) which differentiates the UK from other jurisdictions. In most other jurisdictions, the only available definition is in the AIFM Directive itself, which was intended to be used as a guide to AIFMs seeking to access local markets.

In particular, the FCA has clarified its views on the following points:

- Marketing generally will not include secondary trading in the units of an AIF. Therefore, the listing of AIF units will not necessarily constitute marketing.
- The indirect offering or placement of units of an AIF will be considered as marketing (including the distribution through a chain of intermediaries or a placement agent).
- In certain circumstances, providing draft AIF documentation to potential investors will not constitute marketing.

Importantly, the FCA also provides a view on reverse solicitation, and clarifies that:

"confirmation from the investor that the offering or placement of units of shares of the AIF was made at its initiative, should normally be sufficient to demonstrate that this is the case, provided this is obtained before the offer or placement takes place. However, AIFMs and investment firms should not be able to rely upon such

confirmation if this has been obtained to circumvent the requirements of AIFMD" (*PERG8.37.11G (2), FCA Handbook*).

Following up on ESMA Guidance issued in October 2014, the FCA has also provided additional clarification on feeder funds marketed in the UK. That is, AIFMs marketing a feeder AIF in the UK which invests into a non-EEA master AIF which is not marketed in the UK and is managed by the same AIFM, are not required to report (to the FCA) about the non-EEA master AIF. The FCA does however reserve the right to contact AIFMs to request information on the non-EEA master AIF.

UK national private placement rules. The UK implementing regulations of the AIFM Directive clarify that an EU AIFM of a non-EU AIF, or a non-EU AIFM of a non-EU or an EU AIF, can market such an AIF in the UK, provided it has notified the FCA in advance of its intention to market. In addition to this requirement:

- The AIFM must meet the relevant conditions in the UK implementing regulations (*see below*).
- The AIFM's entitlement to market the AIF must not be subject to a suspension or revocation by the FCA
- AIFMs can market AIFs as soon as a notification containing all of the required information is sent to the FCA and it is not necessary to await approval from the FCA before marketing under the UK's national private placement regime. However, the UK Alternative Investment Management Association (AIMA) recommends that it may be prudent to await confirmation of approval before undertaking any marketing activities (*AIMA Summary AIFMD Implementation and the National Private Placement Regime (see www.aima.org)*).

The relevant conditions of the UK implementing regulations include:

- **For EU AIFMs marketing units of non-EU AIFs to professional investors.** The AIFM must notify the FCA using a standardised form certifying that:
 - the AIFM complies with the AIFMD to the extent required;
 - appropriate co-operation arrangements are in place; and
 - the non-EU country in which the non-EU AIF is established is not listed as a non-co-operative country and territory by FATF.
- **For non-EU AIFM marketing units of EU or non-EU AIFs to professional investors.** The AIFM must notify the FCA using a standardised form certifying that:
 - the non-EU AIFM is the person responsible for complying with the relevant provisions of the AIFM Directive;
 - the Transparency Requirements are met;
 - appropriate co-operation arrangements are in place; and
 - the non-EU country in which the non-EU AIFM or non-EU AIF is established are not listed as a non-co-operative country and territory by FATF.

Sanctions. Entities in contravention of the UK's marketing restrictions will be deemed to have been carrying out "unlawful marketing". The consequences of carrying out unlawful marketing vary depending on whether the concerned AIFM or investment firm is an:

- **Authorised person.** Contravention by an authorised person is actionable at the suit of a private person who suffers loss as a result of such marketing. The FCA can instigate an investigation on such person's behalf.
- **Unauthorised person.** Unauthorised persons in contravention are guilty of an offence and liable to imprisonment, a fine or both, and may be liable to an investigation instigated by the FCA.

FRANCE

Marketing. The French financial regulator, the Autorité des Marchés Financiers (AMF) issued guidance (*Instruction DOC-2014-031*) on 30 June 2014 ("Guidance") on what constitutes marketing under the AIFM Directive. Pursuant to the Guidance, "marketing" is presentation through various means (such as advertising, solicitation, advice) with a view to encouraging a client to buy UCITS or AIFs. The Guidance also set out certain actions that are not considered to be marketing including:

- Replying to a client's unsolicited request to purchase a specifically identified AIF, where allowed by the regulations in force. In this respect, the request should refer to a specifically identified AIF, rather than a given investment strategy.
- Purchase or sale AIF made through a discretionary portfolio management agreement as long as the AIF is admissible for a client's portfolio. In this case, no marketing relationship is considered to exist between the entity that is marketing the funds and the clients of the portfolio manager.

French NPPR. Before units or shares of EU AIFs or non-EU AIFs can be marketed to France-based professional investors, French portfolio management companies, management companies established within the EU, or managers established in countries outside the EU (with or without a passport), the fund manager must notify the AMF of each AIF they intend to market (*Article L. 214-24-1-1, Ordinance 2013-676*). The conditions of this marketing are set out in Decree 2013-687 and the procedures for making such notification are set by the AMF.

EU-based AIFMs marketing AIFs based outside the EU in France. An AIFM must notify the AMF before marketing any non-EU AIF to France-based professional investors. EU AIFMs are required to comply with most of the laws and regulations applicable to French AIFMs (with certain exceptions) and must meet certain additional requirements, including the following (*Decree 2013-687*):

- The basic depository and custody requirements must be carried out by more than one entity and must be subject to the regulatory obligations set by the AMF.

- Appropriate co-operation arrangements must be in place and the non-EU country in which the non-EU AIFM or non-EU AIF is established must not be listed as a non-cooperative country and territory by FATF.
- In addition to the above co-operation agreement, a further co-operation agreement for the exchange of information and mutual assistance in the field of asset management must be entered into between the AMF and the supervisory authority of the AIF.
- Open-ended AIFs must obtain a prior authorisation from the AMF allowing the units or shares to be marketed in France. The AMF will issue such an authorisation only if the non-EU AIF is subject to investor protection and transparency rules that are equivalent to the French rules.

Non-EU AIFMs marketing EU or non-EU AIFs in France. These rules are the same as for EU-based AIFMs marketing AIFs based outside the EU in France (*see above, EU-based AIFMs marketing AIFs based outside the EU in France*).

The above conditions are likely to be very difficult for a non-EU AIF to meet. As a result, these conditions could have effect of shutting off the NPPR system to non-EU AIFs.

CONCLUSION

Before setting out to market an investment fund in the EU, managers of investment funds should consider the three regimes currently in force and weigh up the benefits and costs of each.

Given the strict rules around marketing in the EU, the choice of regime should be made before approaching investors. Both the UCITS and AIFM Directive regimes now offer an EU passport. However, for funds (or AIFs) that cannot fit within those regimes, the EU will remain a patchwork of regulation which must be navigated carefully with the assistance of local counsel in each relevant jurisdiction.

As has always been the case, for those selling in the EU without the benefit of an EU passport, the legal requirements of certain jurisdictions will remain easier to navigate than others.

FEEDER AIF

A feeder AIF is an AIF that invests at least 85% of its assets in the shares of another AIF, or invests at least 85% of its assets in more than one master AIF where those master AIFs have identical investment strategies, or has otherwise an exposure of at least 85% of its assets to one or more such master AIF.

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