

# The European passport

*Derbhil O’Riordan, of Dillon Eustace, remarks on the AIFMD and the challenges Brexit will present to UK fund managers*

**D**irective 2011/61/EU on alternative investment fund managers (AIFMD), applies to the marketing and management within the EU of all non-UCITS alternative investment funds (Aifs) and creates a comprehensive regulatory and supervisory framework for managers of Aifs (AIFMs) at European level.

## Application of AIFMD

In addition to EU AIFMs, the AIFM Directive applies to any non-EU AIFM that:

- manages one or more Aifs domiciled in the EU; and/or
- markets Aifs to investors in the EU (irrespective of the Aif's domicile).

For example, a US-based fund manager managing 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.

Under AIFMD, 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.

## Passporting under AIFMD

AIFMD introduced a single marketing "passport" within the EU for the marketing of EU Aifs by EU AIFMs. However, at the time of writing, such passport is not available to



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non-EU AIFMs or to EU AIFMs with non-EU Aifs.

Although AIFMD does envisage the extension of the passport to non-EU Aifs and non-EU AIFMs, at present only entities established in the EU can be authorised as AIFMs to obtain the marketing passport for their EU-domiciled Aifs. However, when the relevant provisions of AIFMD are "switched on", in respect of a given jurisdiction, non-EU based managers based in the relevant jurisdiction will be permitted to apply to become authorised as an AIFM under the AIFM Directive and market its funds in the EU under the marketing passport.

## Marketing without a passport under AIFMD

Under AIFMD, member states have discretion 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 within their own border, provided the marketing is subject to:

- the member state’s own national private placement regime ("NPPR").
  - the transparency rules imposed by the AIFM Directive (the "transparency rules").
- Countries that intend to allow

private placement must apply the minimum AIFM Directive standards to AIFMs marketing under the regime. In addition to the standard AIFMD requirements, each EU member state can impose its own additional NPPRs in relation to the marketing of the product.

## EU-based AIFMs with non-EU Aifs

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.
- There is a cooperation arrangement between the regulator of the AIFM’s home member state and the supervisory authority of the non-EU country where the Aif is established.

## **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**

- 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 (FATF) on anti-money laundering and terrorist financing.

## Non-EU AIFMs with non-EU Aifs

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 provided:

- The AIFM complies with the Transparency Rules in respect of each Aif and (where applicable) with certain additional rules relating to acquiring control of non-listed entities.
- There is a co-operation arrangement 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 Transparency rules

The Transparency Rules impose specific obligations on AIFMs applicable to all Aifs marketed in the EU. AIFMs must ensure that in respect of all Aifs marketed in the EU, certain minimum disclosure requirements are met in respect of annual reports, disclosures to investors, and disclosures to regulators.

Annual report disclosure requirements include:

- material changes to the Aif 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 must include:

- Remuneration policies and practices for relevant categories of staff to enable investors to assess the incentives created.
- Disclosure on cover for professional liability risks.
- Details of any preferential treatment of investors.
- 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.

Periodic reporting to competent authorities must include:

- The principal markets and instruments traded 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, 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.

## United Kingdom and Brexit

It is expected that in March 2019 the United Kingdom will exit from the EU and the UK will become a "third country" under AIFMD. The UK may therefore lose certain rights that EU managers and AIFMs currently have.

In terms of managing EU Aifs, a UK AIFM will most likely have the same rights as a US AIFM (for example). However, as things stand at the time of writing a UK AIFM could no

longer market its EU-domiciled Aifs cross-border within the EU. Further, cross-border distribution will most certainly be affected.

UK managers that see the EU (even if only a few EU countries) as their target distribution base will need to ensure that they keep a foothold in the EU before enjoying the benefits of EU-regulated entities in the financial services industry.

The available options for UK managers include:

- Setting up an AIFM or Super Manco (that is, a regulated entity that can manage and market both Ucits and Aifs) in another EU member state.
- Using a third party AIFM established in another EU member state.
- Putting their fund on a third-party platform that is already established in another EU member state.

## 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, relevant advices should be sought before approaching investors. 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. HFM