

Cross-border distribution of collective investment undertakings

The impact of the new legislation on Alternative Investment Fund Managers

On 16 April 2019, the European Parliament adopted a package of legislation amending the regulatory framework for the cross-border distribution of investment funds in the European Economic Area (EEA).¹ The legislation takes the form of a directive² and a regulation³ on the Cross-Border Distribution of Collective Investment Undertakings (respectively the **CBDF Directive** and the **CBDF Regulation**). The European Council is expected to formally adopt this legislative package shortly with a view to the new framework becoming effective by the end of 2021.

The new framework aims to further facilitate the cross-border marketing of investment funds by harmonising the differing existing European frameworks for alternative investment funds (AIFs) and UCITS and addressing certain specific lacunae, including the definition of “pre-marketing”. This Regulatory Spotlight examines the new framework with a particular emphasis on its impact on alternative investment fund managers (AIFMs) and distributors marketing AIFs.

Legislative background

The current European framework for marketing AIFs is set out in the Alternative Investment Funds Manager Directive⁴ (AIFMD). The amendments to this framework have been primarily driven by concerns surrounding the divergent regulatory and supervisory approaches to the cross-border distribution of AIFs and UCITS.

The legislative proposals in their original form were tabled by the European Commission in March 2018. Following political agreement between the European Parliament and Council in early February this year, the European Parliament has now passed what are expected to be the final legislative texts. The Council will still need to formally adopt the legislation but is expected to do so soon without further changes. EEA Member States will then need to pass national implementing legislation and the bulk of the new rules will enter into force two years later, likely by the end of 2021.

Current challenges for investment managers wishing to market funds across the EEA

The AIFMD contains a comprehensive marketing passport regime which allows EEA domiciled AIFMs and their appointed distributors to market EEA AIFs on a pan-EEA basis. Nevertheless, AIFMs currently face a number of challenges, including:

- **Pre-marketing:** there is a lack of uniform definition of what constitutes “pre-marketing” activities. This makes it difficult for investment managers to test the appetite for a new product without having to incur substantial prior set up and passport notification costs;
- **De-notification requirements:** there are no specific rules addressing the requirements or process for notifying a local regulator that the AIFM no longer wishes to market interests in the AIFs in a given Member State;
- **Regulatory transparency and regulator efficiency:** there are divergent registration costs (both initial and recurring fees) between Member States to register funds for marketing in a host jurisdiction with no straightforward means for investment managers to find out the fees payable;
- **Form and content of marketing communications:** there are different local marketing requirements so that, in some member states, additional pre-approval of fund marketing documentation or even additional marketing material may be required by a host state regulator; and
- **Reverse solicitation:** there is no clear unified definition of reverse solicitation within the EEA – even within some Member States there are widely differing views as to the definition of reverse solicitation and the extent to which it can be relied upon.

Taken together, these and other factors can delay and render costly cross-border fund marketing campaigns. In addition, there is confusion over the impact of Brexit on the cross-border marketing of funds by UK investment managers into the remaining Member States following Brexit.

¹ The texts of the new legislative package have EEA relevance (the EU 28 Member States plus Norway, Iceland and Lichtenstein).

² Cross-Border Distribution of Collective Investment Undertakings Directive, text available [here](#).

³ Cross-Border Distribution of Collective Investment Undertakings Regulation, text available [here](#).

⁴ Alternative Investment Fund Managers Directive (Directive 2011/61/EU), text available [here](#).

Pre-marketing

The AIFMD has been amended to enable pre-marketing of an EEA AIF by an EEA AIFM to prospective professional investors across the EEA. Pre-marketing may occur either in respect of a yet to be established AIF or an existing AIF in a host Member State where the manager wishes to test investor appetite. In either case, pre-marketing will be permissible without the need to obtain an AIFMD marketing passport or submit a notice under any relevant National Private Placement Regime (**NPPR**).

Pre-marketing is now defined in the CBDF Directive⁵ as the:

... provision of information or communication, direct or indirect, on investment strategies or investment ideas by an EU AIFM or on its behalf to potential professional investors domiciled or with a registered office in the Union in order to test their interest in an AIF or a compartment which is not yet established, or which is established, but not yet notified for marketing in accordance with Article 31 or 32 [of the AIFMD], in that Member State where the potential investors are domiciled or have their registered office, and which in each case does not amount to an offer or placement to the potential investor to invest in the units or shares of that AIF or compartment ...

Whilst this definition of pre-marketing is helpful, it is worth noting that:

- pre-marketing can take place so long as it does not involve the provision of draft or final subscription documents for an existing AIF or, where an AIF is at the pre-launch stage, the provision of a final fund prospectus or offering documents. The circulation of draft documents or other marketing material is permitted. This is narrower than what is currently permissible in certain jurisdictions where the AIFMD marketing rules have been implemented or interpreted such that the circulation of draft subscription documents to prospective investors do not constitute marketing. Investment managers may need to revisit whether draft subscription documents can still be provided alongside other draft fund documents;
- a subscription by a professional investor to interests in an AIF within eighteen months of pre-marketing will be considered to be as a result of that pre-marketing. This is important as it curtails the ability of fund managers to rely on reverse solicitation. In practice, regulators in some Member States have already adopted a similar approach;
- any draft documents supplied must contain wording clearly indicating that they do not constitute an offer to subscribe for units or shares of an AIF and that they should not be relied on and may be subject to change;
- EEA AIFMs must send, within two weeks of beginning any pre-marketing, an informal letter to the competent authority of its home Member State specifying the Member States in which it is conducting or has conducted pre-marketing. The letter must include the duration and brief details of the pre-marketing. The home state regulator must then notify the competent authority of the host Member State(s) of the pre-marketing and supply any further information the host state regulator may request; and
- the changes relate solely to pre-marketing vis-à-vis professional investors. Where local rules allow the offering of AIFs to retail investors, it will still be necessary to carefully consider whether any pre-marketing to a retail investor is permissible under local rules.

De-notification requirements

New rules have been introduced in relation to the cessation of marketing activities in a Member State.⁶ EEA AIFMs will now be able to cease the marketing of a fund in a Member State via a simple notification to their home state regulator. The home state regulator has up to fifteen working days from receipt of the notification to check its completeness and transmit it to the relevant host state regulator.

The de-notification procedure involves some obligations on the EEA AIFM. It must:

- publicly offer – over a thirty day period – to repurchase or redeem shares or units of AIFs (excepting closed-ended AIFs) in the relevant Member State, free of any deductions or charges;
- publicise the intention to cease marketing in the relevant Member State; and
- modify or terminate, with effect from the date of notification, any contractual arrangements with intermediaries.

Regulatory transparency and regulator efficiency

The new rules will oblige local regulators to make publicly available information on the fees, fee calculation methodologies and summaries of local marketing rules applying in their jurisdiction⁷.

The European Securities and Markets Authority (**ESMA**) will be required to maintain a database of national marketing rules which will act as a central repository⁸. Perhaps of most benefit in practice is the requirement for ESMA to develop an online

⁵ New article 4(1)(aea) AIFMD as inserted by Article 2(1), CBDF Directive.

⁶ New article 32a AIFMD as inserted by Article 2(4), CBDF Directive.

⁷ Articles 5 and 10, CBDF Regulation.

⁸ Article 12, CBDF Regulation.

interactive tool enabling EEA AIFMs to calculate the regulatory fees that will be payable in a particular member state in the connection with the marketing of an EEA AIF.⁹

Arguably an opportunity has been missed to harmonise the differing approaches that local regulators have taken to the NPPR for third country investment managers under Article 42 of the AIFMD. At present, there is a considerable divergence in approach across the Member States, with some requiring the appointment of a so-called depositary-lite and the production of additional documentation as part of the NPPR application process. In addition, some local regulators grant approval to market under their NPPR in 24 hours whereas others can take several months or more.

Form and content of marketing communications

AIFMs are now obliged to ensure that all marketing communications addressed to investors are identified as marketing communications and "*describe the risks and rewards of purchasing units or shares of an AIF ... in an equally prominent manner.*"¹⁰ The marketing communications must be clear, fair and not misleading.

ESMA has been tasked with drafting guidelines on the form and content of marketing communications and specifically on-line marketing communications. EEA AIFMs will want to follow this process closely and may wish to consider early policy engagement with ESMA in the development of these guidelines.¹¹

Together with the new regulatory transparency outlined above, this should assist EEA AIFMs to navigate local marketing requirements and make it easier to make informed cost-benefit judgments when drawing up their marketing plans.

Ominous signs for reverse solicitation?

At present, many third country investment managers rely on reverse solicitation in certain circumstances and in certain jurisdictions. In a perhaps ominous sign for the future use of reverse solicitation however, the European Commission has been tasked with preparing a report within the next two years on reverse solicitation. The report will specify the extent to which subscriptions to interests in funds result from reverse solicitation, the geographical distribution of reverse solicitation and its impact on the passporting regime.

It remains to be seen whether this will ultimately lead to a more concerted effort by the European regulators to prohibit reliance on reverse solicitation.¹²

How will these changes affect non-EU third country investment managers?

The new measures will apply to EEA AIFMs marketing EEA AIFs. Non-EEA investment managers and non-EEA AIFs are not directly in scope of these measures. That said, certain changes, such as the clearer definition of pre-marketing, may in practice find their way into local private placement rules. Any further rules on reverse solicitation will no doubt have a direct impact on non-EEA investment managers.

What about Brexit?

Whether UK investment managers will become subject to, and benefit from these new rules, will to a large extent depend on how the Brexit negotiations between the UK and the EU conclude over the next weeks, months and years.

If there is an orderly withdrawal of the UK from the EU and a transitional period during which EU rules will continue to apply, the UK will be expected to adopt and implement EU legislation during that period. This would include these new measures. It is also likely that following the end of the transitional period, the UK will in practice shadow EU legislation on an ongoing basis with a view to being deemed equivalent so that it can maintain preferential access to the EU's single market for financial services.

However, in the event of a hard Brexit (meaning the UK leaving the EU without an agreed deal and with no transitional measures), all UK AIFMs will become non-EEA investment managers from the exit date (currently set as 31 October 2019).¹³ In such a scenario, it is not clear that these measures would be implemented by the UK government and their practical benefit to UK AIFMs would be greatly reduced due to UK AIFMs becoming non-EEA investment managers. Further, it is possible that in the event of a hard Brexit the UK will choose not to shadow the EU's financial services legislative agenda, which could in time result in a significant divergence between the UK and EU's approach.

⁹ Article 11, CBDF Regulation. ESMA has been given 30 months lead time to develop this tool.

¹⁰ Article 4(1), CBDF Regulation.

¹¹ Article 4(6), CBDF Regulation.

¹² Article 18, CBDF Regulation.

¹³ It is worth noting however, that some Member States may well put in place temporary transition measures to blunt the immediate impact of a cliff-edge hard Brexit in the initial few months.

If you have any questions, please do not hesitate to contact your usual AG contact or one of the lawyers listed below:

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Please also see our previous Regulatory Spotlights on the marketing of investment funds:

HARD BREXIT: IMPLICATIONS AND PRACTICAL SOLUTIONS (5 September 2018), available [here](#).

MARKETING INTERESTS IN FUNDS TO UK INVESTORS POST-BREXIT (19 February 2019), available [here](#).

MARKETING INTERESTS IN FUNDS TO EEA INVESTORS POST-BREXIT (26 February 2019), available [here](#).
