ALLEN & OVERY

GREAT FUND INSIGHTS

Cross-Border Distribution of Collective Investment Funds

New Rules – June 2019

Introduction

The regulatory landscape for marketing funds in Europe is complex due to the divergent approaches taken by the various Member States in implementing fund distribution and marketing rules. The intention of the new rules for the cross-border distribution of funds is to take steps towards addressing this lack of harmonisation and they are comprised in a new directive and a new regulation (together, the "**Adopted Texts**").[1]

We will address the key changes stemming from these Adopted Texts in terms of their impact on the AIFMD but also touch in some instances on the UCITS Directive where there are corresponding obligations and rules for AIFMs and UCITS. In particular, we will focus on:

– the new rules concerning **pre-marketing** by an EU AIFM ahead of seeking an AIFMD passport and entering into the within 20 working days [after the] marketing passport approval period

– changes to the requirements regarding **local facilities** when marketing to investors in a particular Member State

– the rules governing the **cessation of marketing** in a Member State commonly referred to as "de-notification"

– clarification of **regulatory fees** that may be charged by Member State regulators in respect of marketing notifications

– efforts to increase the transparency of each Member State's marketing rules with the introduction of an **ESMA database**

Legislative background

The Council first announced the intended proposals in March 2018, and adopted final texts of the **Directive** and **Regulation** on 14 June 2019. The final act was signed into law on 20 June 2019 and is now awaiting publication in the Official Journal of the EU (there is no current indication of when this publication date will fall). It will enter into force 20 days following publication in the Official Journal. The Regulation will apply from that date, with the exception of Articles 4(1) to (5), Articles 5(1) and (2), Article 15 and Article 16, which will apply from 24 months after the date of entry into force and will not be operative before 2021. The latter are provisions covering requirements for marketing communications and the publication of national provisions concerning marketing requirements as well as EuVECA and EuSEF related definitions. As for the Directive, Member States have 24 months to transpose it into their local law after the date of its entry into force and so it is expected to apply across the EU in mid-to-late 2021.

Irrespective of the outcome of Brexit and the fact that the UK may no longer be a member of the EU when the proposed legislation becomes effective, the Adopted Texts will nevertheless have an impact on UK managers. From a UK perspective the new harmonised pre-marketing regime is very similar to the current UK position, except for certain new requirements such as the additional layer of notification described further below. In addition, the AIFMD's text is being amended in a manner which falls largely in line with the existing FCA view on marketing AIFs.

As the pre-marketing requirements apply only to EU AIFMs, uncertainty remains as to whether non-EU AIFMs will continue to conduct pre-marketing in the EU under individual National Private Placement Regimes ("**NPPRs**"). It is possible that individual Member States may seek to amend their interpretation of "marketing" for these purposes and/or adapt their rules under their NPPRs to reflect these changes (see further below for additional commentary on this in the section titled "Pre-marketing by a Non-EU AIFM – Is there any Impact?").

1 (i) the Directive of the European Parliament and of the Council amending Directive 2009/65/EC (UCITS) of the European Parliament, and of the Council and Directive 2011/61/EU (AIFMD) of the European Parliament and of the Council with regard to the cross-border distribution of collective investment undertakings (the "**Directive**"); and (ii) the Regulation of the European Parliament and of the Council on facilitating the cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014 (the "**Regulation**").

Pre-marketing by an EU AIFM of an EU AIF via the AIFMD Marketing Passport

One of the most significant changes introduced by the Adopted Texts is a harmonised approach to the activity of pre-marketing and the definition thereof. This approach will apply to EU AIFMs marketing EU AIFs pursuant to the AIFMD Marketing Passport.

Under the Adopted Texts, pre-marketing will be defined 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, 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*".

The newly harmonised pre-marketing rules will comprise the following elements:

– Any marketing communication (direct/indirect) should be addressed to potential professional investors only and should relate only to an investment idea or strategy to test their interest in an AIF

– Distribution (to potential professional investors) of documents for pre-marketing purposes can now be done either before or after the AIF is established (assuming the AIF has not been registered for a marketing passport in accordance with AIFMD Article 31 or Article 32)

– The following rules apply to the types of pre-marketing documents that may be distributed:

– no subscription documents (even if in draft form) should be distributed to investors

– No final form constitutional documents/PPM should be distributed to investors. This will be an issue of substance and not just form (ie being labelled as 'draft')

– Where draft form documents/PPM are provided, the marketing rubrics should clearly state that:

– the documents do not constitute an offer/invitation to subscribe to units/shares of an AIF

– the information in the draft documents should not be relied on because it is incomplete and remains subject to change

– AIFMs should ensure that investors do not actually acquire interests in the AIF on the basis of any such pre-marketing fund documents

– Any third party conducting pre-marketing on behalf of the EU AIFM in the EU needs to be regulated under MIFID II CRD/UCITS IV Directive/AIFMD or act as a tied agent. Such third party will be subject to all the same conditions as the EU AIFM

– Any pre-marketing process should be adequately documented and recorded by EU AIFMs, while the pre-marketing materials must be clear, fair and not misleading. All marketing communications addressed to investors are to be identifiable as such and describe the risks and rewards of purchasing units or shares of an AIF or units of a UCITS in an equally prominent manner

– Harmonised rules on pre-marketing should not in any way disadvantage EU AIFMs vis-à-vis non-EU AIFMs

Impact on reverse enquiries

The Adopted Texts are also intended to constrain the route of often problematic "reverse enquiries". Any subscription by professional investors within 18 months of an EU AIFM beginning pre-marketing, whether or not correctly notified, shall be considered the result of active marketing (not on the basis of a reverse enquiry) and therefore required to be made in accordance with AIFMD Articles 31 and 32.

The geographic scope of this provision from the Directive is not yet clear. As the aim of the Directive has been presented in terms of ensuring a level playing field among collective investment undertakings, it is unclear whether an investment based on a reverse enquiry should be possible in Member State A during the 18-month period of the EU AIFM beginning pre-marketing in Member States B and C, even if no information or communication, direct or indirect, has been provided in Member State A. Therefore Member State regulators may interpret this provision widely such that any pre-marketing in a Member State will restrict the ability to rely on reverse enquiry in all other Member States. Asset managers may therefore need to accept the practical impact of this, whereby accepting an investment commitment based on a reverse enquiry is only possible prior to the 18-month period of the EU AIFM beginning pre-marketing. We note that the European Commission has committed to evaluating the operation of the reverse enquiry regime and its impact on the passporting regime within 24 months of the Regulation entering into force.

Additional pre-marketing notification requirement

The most notable new requirement under the Adopted Texts is for the EU AIFM to send, within two weeks of beginning pre-marketing, an informal letter (in paper form or by electronic means) to the EU AIFM's home Member State regulator, specifying the relevant Member States in which, and the periods during which, the pre-marketing is taking or has taken place, and a brief description of the activity undertaken (including information on investment strategies presented, and a list of its (proposed) AIFs and sub-funds which are or were the subject of pre-marketing). The home Member State regulator will then promptly share this information with the relevant host Member State regulator(s) where the EU AIFM is or has been engaged in conducting the pre-marketing.

The industry has raised concern that this development is a step backwards and is not justified, because it is seen as introducing another notification process in addition to the existing requirement. Indeed the purpose of pre-marketing is to gauge investor interest and test the waters before committing to an official process involving Member State regulators. The introduction of the new requirement to send an informal letter within a specified time-frame presents a firm with another way in which it could potentially breach the rules. It could also be argued that the informal notification is not justifiable on data collection grounds, as the Member State regulators are already notified when full AIFMD marketing commences and thus have the ability to collect data at that stage regarding the type of AIFs that are being marketed in their jurisdiction.

In addition, Member State regulators may require prior notification of marketing communications for ex-ante verification purposes. Where national competent authorities require prior notification, this should not prevent them from verifying marketing communications ex-post.

Please refer to the Appendix below containing a high-level analysis of pre-marketing in the form of a matrix, based on the Adopted Texts. The matrix considers whether certain common offering documents or communication activities come within the scope of the new pre-marketing definition, or would be considered as marketing.

Pre-marketing by a non-EU AIFM – is there any Impact?

As mentioned at the outset, the Adopted Texts do not extend to the pre-marketing of non-EU AIFs by EU AIFMs (via AIFMD Article 36 under applicable NPPRs) or AIFs by non-EU AIFMS (via AIFMD Article 42 under applicable NPPRs). As such, the existing position in each jurisdiction may continue whereby individual Member States are left to determine their own position regarding whether pre-marketing of such AIFs is permitted, and on what basis. By way of illustration, the UK and Luxembourg have very workable existing pre-marketing regimes for AIFs being marketed via AIFMD Article 36 or 42. In other Member States some pre-marketing may be possible, but conditions apply.

However, the Adopted Texts state that non-EU AIFMs cannot be treated more favourably than EU AIFMs by Member States, in order to ensure a level playing field. Therefore the new pre-marketing rules set out above, and in particular the new two-week informal letter notification requirement may possibly also apply to the pre-marketing of AIFs which fall under the AIFMD Article 36 or 42 scenarios. As such, EU AIFMs marketing non-EU AIFs and non-EU AIFMs marketing any AIF may be confronted with the extension of such pre-marketing requirements and reverse solicitation restrictions through new local laws which amend currently available NPPRs. The position is summarised as follows:

EU AIFM/EU AIF (AIFMD Articles 31 and 32): Harmonised pre-marketing regime according to the Adopted Texts.

EU AIFM/Non-EU AIF (AIFMD Article 36): It is up to the Member State to determine whether pre-marketing ahead of any required notification under applicable NPPRs is permitted and on what terms; but these cannot be more favourable than the position for EU AIFMs/EU AIFs according to the Adopted Texts. Therefore, the notification requirement and reverse solicitation restrictions may also apply for pre-marketing of funds which fall into the AIFMD Article 36 scenario.

Non-EU AIFM/EU AIF or non-EU AIF or any AIF (AIFMD Article 42): It is up to the Member State to determine whether pre-marketing ahead of any required notification under applicable NPPRs is permitted and on what terms; but these cannot be more favourable than the position for EU AIFMs/EU AIFs according to the Adopted Texts. Therefore, the notification requirement and reverse solicitation restrictions may also apply for pre-marketing of funds which fall into the AIFMD Article 42 scenario.

De-notification of marketing by an EU AIFM or UCITS manager

To date, the conditions to discontinue marketing activities have been unclear and not aligned among Member States. The Directive harmonises the procedure and conditions for both UCITS and EU AIFs to cease the marketing of their shares/units (ie de-notification) after using the EU marketing passport in a Member State.

An EU AIFM or UCITS manager may only discontinue marketing if the following conditions are met:

– The EU AIFM or UCITS manager has made a blanket offer to repurchase the shares/units in the EU AIF/UCITS free of any charges and such offer is (i) publicly available for at least 30 business days, and (ii) individually addressed to known investors in that Member State. Closed-ended funds and European Long-term Investment Funds ("**ELTIFs**") have been exempted from this condition as redemptions would not be feasible in practice due to the illiquid nature of such funds. For UCITS, the notice to investors must also clarify the consequences if shares/units are not redeemed.

– The intention to cease marketing in the relevant Member State is made public (including electronically) in a manner which is customary for marketing AIFs/UCITS and suitable for the AIF's/UCITS' investors.

– Any contracts with distributors/financial intermediaries are modified or terminated with effect from the date of de-notification.

The home Member State is charged with verifying that the pre-conditions in respect of the UCITS/AIFM are met and, if so, will notify the national competent authority of the Member State where discontinuation of marketing is sought, no later than 15 working days from receipt of the completed notification.

For 36 months from the date of de-notification, there should be no pre-marketing carried out in the concerned Member State by AIFMs of an AIF referred to in such notification, or in respect of a "similar investment strategy or investment idea". This may potentially reduce the appeal of the de-notification process for external AIFMs with several AIFs under management.

The AIFM or UCITS manager will be released by the national competent authorities of its home Member State from the requirement to demonstrate compliance with any national laws, regulations and administrative provisions governing marketing requirements (set out in the Regulation) as from the date of transmission of the de-notification file. However, certain transparency requirements (eg annual report[s] and periodic disclosure) remain applicable for investors and Member State regulators for as long as investors are invested in the relevant AIF/UCITS.

Other key elements of the Adopted Texts

– AIFMs (both EU and non-EU) and UCITS will be required to provide **local facilities** (ie to allow for subscriptions and redemptions) where they are marketing an EU or non-EU AIF **for retail investors** in the EU, albeit a physical presence in the host Member State in connection with these facilities is no longer required.

– There is a requirement on the AIFM to ensure that the **facilities to perform tasks for retail investors** must be made available "*in the official language or one of the official languages of the Member State where the AIF is marketed or in a language approved by the competent authorities of that Member State*".

– **Increased transparency** on the rules that apply when marketing funds into Member States and enhancement of investor protections are to be met through the requirement that each Member State regulator makes information more easily available on its website (including summaries of the rules). ESMA will collate this information in a **central ESMA database** containing such summaries and hyperlinks to the websites of national competent authorities.

– In order to promote good practices of investor protection which are enshrined in the national requirements for fair and clear marketing communications, including online aspects of such marketing communications, **ESMA guidelines** should be issued on the application of those requirements for marketing communications.

– There are some minor changes in relation to **marketing AIFs to retail investors** (such as to ensure that the information prescribed in AIFMD Articles 22 and 23 is made available to retail investors).

– Home and host Member State regulators must ensure that any **fees or charges** levied in carrying out their duties in relation to the cross-border activity of AIFMs or UCITS managers must be consistent with the overall cost to the national competent authority of carrying out their functions, although this requirement does not seem to extend to the fees it may charge non-EU AIFMs seeking to market under NPPRs. Member State regulators will also be required to publish and maintain a central database of applicable fees and charges on their respective websites. To date, fees charged by Member State regulators have in certain instances varied greatly and it is intended that this increase in transparency will lead to harmonisation of such fees and charges across the EU.

– Confirmation that UCITS will be exempted from the requirement to replace their KIIDs with the **PRIIPs KID** for a further two years (ie until December 2021).

Next steps

The European Commission will continue to consider:

– the possible extension of the harmonised pre-marketing regime to UCITS funds

– the operation of the reverse enquiry regime and its impact on the passporting regime

– all provisions of the AIFMD in the context of their application to third country firms, before the third country AIFMD marketing passport is made available, although the industry view is that the third country marketing passport is unlikely to be extended any time soon

Appendix

Pre-marketing matrix

- Pre-marketing
- Marketing
- Could be pre-marketing or marketing
- Not pre-marketing or marketing

Item		Is it pre-marketing?	Status/Comments
a.	Roadshows	Yes	AIFMs should make sure that the information provided does not enable investors to actually acquire interests in the fund through pre-marketing.
b.	Discussions on investment strategies or investment ideas with select existing investors in existing funds or potential investors to test their appetite for making new investments in an AIF but without securing a commitment to subscribe and without amounting to an offer or placement to the investor to invest	Yes	AIFMs should make sure that the information provided does not enable investors to actually acquire interests in the fund through pre-marketing.
c.	Generic materials which refer to investment strategy/characteristics of a fund without naming the fund	Yes	
d.	Pitchbook/Presentation/Term Sheet/Teaser Document (whether in draft form or final form)	Yes	This should not contain information sufficient to allow investors to take an investment decision. The rubrics on the document should clearly state that: – it does not constitute an offer/invitation to subscribe to units/shares of an AIF – the information in the document should not be relied on because it is incomplete and subject to change
e.	DDQ as requested by potential investors from managers	Yes	This should not contain information sufficient to allow investors to take an investment decision. It is recommended, in order to avoid the DDQ being viewed as an offer to invest, that the rubrics on it clearly state that: – it does not constitute an offer/invitation to subscribe to units/shares of an AIF – the information in the DDQ document should not be relied on because it is incomplete and subject to change
f.	Draft PPM/Draft Offering Document /Draft Prospectus (all for an AIF which is not yet established, or which is established, but not yet notified for marketing under AIFMD Article 31 or 32)	Yes	This should not contain information sufficient to allow investors to take an investment decision. The rubrics on the **draft** should clearly state that: – it does not constitute an offer/invitation to subscribe to units/shares of an AIF – the information in the draft document should not be relied on because it is incomplete and subject to change

Item		Is it pre-marketing?	Status/Comments
g.	Draft Memorandum and Articles of Association/Draft Fund Constitutional Documents including Draft LPA (all for an AIF which is not yet established, or which is established, but not yet notified for marketing under AIFMD Article 31 or 32)	Yes	This should not contain information sufficient to allow investors to take an investment decision. The rubrics on the **draft** should clearly state that: – it does not constitute an offer invitation to subscribe to units/shares of an AIF – the information in the draft document should not be relied on because it is incomplete and subject to change
h.	Negotiation of Draft Memorandum and Articles of Association/Draft Fund Constitutional Documents including Draft LPA negotiations	This could be pre-marketing or marketing	This will depend on how extensive the negotiations are and whether an offer to invest/subscribe has already been made.
i.	Draft Subscription Documents	No, this is marketing	Even draft form subscription documents must not be circulated during pre-marketing.
j.	Final PPM/Final Offering Document/Final Prospectus (all for an AIF which is not yet established, or which is established, but not yet notified for marketing under AIFMD Article 31 or 32)	No, this is marketing	
k.	Final Memorandum and Articles of Association/Final Fund Constitutional Documents including Final LPA (all for an AIF which is not yet established, or which is established, but not yet notified for marketing under AIFMD Article 31 or 32)	No, this is marketing	
l.	Final Subscription Documents	No, this is marketing	There should be no circulation of final or draft form subscription documents during pre-marketing. Any subscription by investors within 18 months of the EU AIFM having begun pre-marketing shall be considered to be the result of marketing and subject to notification requirements under AIFMD Articles 31 and 32 (ie EU AIFMs must notify within 18 months of starting pre-marketing). Reliance on reverse solicitation will be accordingly restricted once pre-marketing has commenced.
m.	Generic Corporate Brochure (describing AIFM's business generally and setting out team member credentials with no description of fund investment strategies or ideas for new AIFs) Generic presentations of market trends and developments in the funds industry	Not pre-marketing or marketing, but will ultimately depend on specific content and circumstances on a case-by-case basis	There will be a need to take into account the extent to which such activities are permitted pursuant to the compliance policies and procedures of each AIFM. Also consider impact on ability to rely on reverse enquiry.