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A Brief Guide to Marketing Investment Funds in the EU

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This article provides a brief guide to marketing investment funds in the EU. This article sets out the three main investment fund regimes currently operating within the EU; the types of funds applicable to each regime; and the types of investors likely to be targeted in each of the three regimes. This article also provides a brief comparison of the national private placement rules in the United Kingdom and France.

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 for selling non-EU funds in the EU 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 which will generally fall within each regime.
- The type of investors likely to be targeted in each of the three regimes.



1. 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. Most recently, the so-called UCITS V regime was transposed into national law of member states (by 18 March 2016) and further enhanced harmonisation in three main areas including:

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

This harmonised regime has allowed for a wide variety of investment strategies within the UCITS framework. These investment strategies are all subject to the UCITS product rules, which can be implemented, in a uniform manner across each of the EU member states (because of the European Securities and Markets Authority (ESMA)).

2. 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.

3. Notification Procedure

Under the UCITS regime, the notification procedure for cross-border distributions of UCITS comprises a simple electronic regulator-to-regulator 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)



It should be noted, however, that additional requirements are applied in certain EU jurisdictions and care should be taken to familiarise with the individual requirements of specific jurisdictions before commencing the passporting process.

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.

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 EC Council Directive 2009/65/EC of 13 July 2009 as amended by Directive 2014/91/EU of 23rd July, 2014 and as may be amended, consolidated or substituted from time to time (UCITS 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.



4. 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).

5. 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 (the legislation contemplated earliest possible extension of the regime being October 2015, but no non-EU jurisdiction has benefitted from any such extension to date) 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) 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.



At the time of writing, only entities established in the EU can be authorised as AIFMs to obtain the marketing passport for their EU domiciled AIFs. However, ESMA and the European Commission are currently analysing the suitability of a number of non-EU jurisdictions with a view to deciding whether they will decide to “switch on” certain provisions of the AIFM Directive for those jurisdictions.

On the basis of this advice, the Commission will, pursuant to the provisions of the AIFMD, adopt a delegated act specifying the date when the EU passport would be extended to non-EU AIFs and non-EU AIFMs. However, it is worth bearing in mind 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 the relevant criteria set out in AIFM Directive will benefit from extension of the passport.

To date, ESMA has assessed 12 countries (Australia, Bermuda, Canada, Cayman Islands, Guernsey, Hong Kong, Japan, Jersey, Isle of Man, Singapore, Switzerland, and the US) under a number of headings. These include areas such as:

- Satisfaction of memoranda of understanding (MoUs) under Articles 35 and 37 of AIFMD.
- Cooperation between local and foreign regulators.
- Competition obstacles.
- Systemic risk monitoring.

ESMA has issued its advice to the Commission on whether to extend the passporting regime to the management and marketing of AIFs by non-EU AIFMs, and to marketing non-EU AIFs by EU AIFMs in these countries. This advice is now being considered by the European Commission, Parliament and Council. However, the passporting regime has not been extended to date despite the relatively positive assessments of a number of regimes (including, in particular, Canada, Guernsey, Japan, Jersey and Switzerland).

Where 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. However, for the time being, 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).

6. EU-based AIFMs with AIFs inside the EU: Notification procedure

Since 22 July 2013, subject to a straightforward notification process, EU-authorised 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 AIFs) 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.

7. Feeder AIFs

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.

8. 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.

9. 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, 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, depending on the jurisdiction in which they are established. 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.

10. 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 ESMA being issued on a country-by-country basis 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.

11. 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.



12. 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, it is necessary to obtain advice on a jurisdiction-by-jurisdiction basis before sell in the EU under the NPPRs. Also, NPPRs vary from state to state.

13. United Kingdom and Brexit

On 23 June 2016, the UK held a referendum on its membership in the EU. A majority of those voting voted for the UK to leave the EU.

On the UK's exit from the EU, the UK will no longer (subject to the outcome of the negotiations with the EU) have the benefit of the UCITS Directive and AIFMD. Therefore, the UK can lose certain rights that EU managers and AIFMs currently have. These include the following:

- A UK investment manager of a UCITS that is established in another EU member state will no longer have the benefit of an EU passport to distribute its UCITS in the EU (subject to any solution reached in the exit negotiations). Therefore, the UK investment manager will need to either:
 - engage authorised distributors with the necessary capacity in the EU member states where it seeks to distribute its UCITS; or
 - set up its own EU-based distributor (or UCITS ManCo).
- Other solutions could also be available, such as having UCITS board members represent it in cross-border sales (assuming the UCITS itself has passporting rights). However, this solution assumes a corporate UCITS structure and may not apply if the UCITS is externally managed.
- In terms of managing EU AIFs, a UK AIFM will most likely have the same rights as a US AIFM (for example). However, a UK AIFM could no longer market its EU-domiciled AIFs cross-border within the EU. Although, similar to a US AIFM, a UK AIFM could act as investment manager to Irish funds and so continue its management activities, 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 a UCITS ManCo, AIFM or Super ManCo (that is, a regulated entity that can manage and market both UCITS and AIFs) in another EU member state (such as Ireland or Luxembourg).
- 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.

Although the second and third options certainly benefit from economies of scale (both in terms of start-up and ongoing maintenance costs), they should both be considered carefully in terms of practical distribution issues and future business growth.

In 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.