

CLIENT ALERT

The EU Cross-Border Distribution Rules: The Impact on Non-EU AIFMs

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BACKGROUND

The EU's new regulatory framework facilitating the cross-border distribution of funds will apply from 2 August 2021. The European Commission has adopted both a new directive (the "CBDF Directive") and regulation (the "CBDF Regulation") (the CBDF Directive and Regulation together "CBDF"). The new rules amend the Alternative Investment Fund Managers Directive ("AIFMD")¹ with the objective of better harmonising the ability of EU alternative investment fund managers ("AIFMs") to distribute alternative investment funds ("AIFs") across the EU, including by introducing a new regime for "pre-marketing."

The CBDF aims to align marketing notification procedures and introduces a new process for filing a de-notification in respect of the marketing of an EU AIF.

Although the CBDF applies to EU AIFMs or persons acting on their behalf (such as a distributor or a placement agent), as the CBDF Directive has to be transposed into each member state's local law, it will be for each member state to determine the extent to which the rules apply to non-EU AIFMs.

¹ Certain of the new rules also apply to Undertakings for the Collective Investment in Transferable Securities (UCITS) but will not be addressed in this client alert.

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The purpose of this client alert is to summarise key elements of the CBDF and the potential impact on non-EU AIFMs wishing to market in the EU.

PRE-MARKETING

The AIFMD does not contain a definition of “pre-marketing” which has meant that, to date, managers wanting to pre-market in the EU have had to take account of any rules or guidance applied in each member state as to what may be done in a member state in advance of “marketing” under the AIFMD. This has led to a very inconsistent approach which is difficult for managers and their agents to navigate. It has also led to different approaches as to the timing of when it may be acceptable to rely on a reverse solicitation request from a prospective investor prior to the commencement of any marketing. The CBDF aims to remove this uncertainty by defining “pre-marketing” and putting in place a notification process for pre-marketing. Reverse solicitation cannot occur within 18 months of pre-marketing notices being made.

The CBDF defines pre-marketing as:

“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... 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”.

In keeping with this definition, the information provided to investors must not:

- be sufficient to allow investors to commit to acquiring units or shares of a particular AIF;
- include subscription forms or similar documents, whether in a draft or a final form; or
- amount to constitutional documents, a prospectus or offering documents of a not-yet-established AIF in a final form.

A draft prospectus or offering documents can be provided in connection with pre-marketing, provided that:

- they do not contain sufficient information to allow professional investors to take an investment decision;
- they do not constitute an offer or an invitation to subscribe to units or shares of an AIF; and
- it is clear that the information presented should not be relied upon because it is incomplete and may be subject to change.

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WHO CAN CARRY OUT PRE-MARKETING?

If an EU AIFM appoints a person to carry out pre-marketing on its behalf (e.g. a placement agent or distributor), the CBDF will only permit certain types of authorised EU financial institutions to engage in pre-marketing activities on their behalf, those being MiFID firms and their tied agents, banks, UCITS management companies, and other EU AIFMs. This will limit the ability of EU AIFMs to use non-EU distributors/placement agents at the pre-marketing stage.

In practice, regulators in each member state have different views as to which activities in connection with marketing a fund are regulated activities. For example, a placement agent may have to consider whether it is involved in “reception and transmission of orders”, “investment advice”, “placement of financial instruments without a firm commitment basis” in connection with promotion of a fund. This has particularly been brought into focus post Brexit where UK and other non-EU placement agents and non-EU MiFID firms have to determine how they may engage with potential investors in the EU. Whilst the regulatory requirements for EU managers and their agents engaged in pre-marketing may be clear, non-EU firms involved in pre-marketing will need to check local implementation rules to establish the degree to which they may be involved.

REVERSE SOLICITATION

Any subscription made within 18 months of pre-marketing activity taking place will be considered to be the result of marketing, for which a marketing notification must be made. Consequently, commencing any pre-marketing activity will preclude reliance on reverse solicitation for a period of 18 months. This requirement is likely to present problems for managers who raise funds on a regular basis with strategies similar to funds previously marketed in the EU.

At present, it is unclear whether the 18 month ban on reverse solicitation should be interpreted broadly so that it prohibits reliance on reverse solicitation in all member states with respect to the AIF which was the subject of the pre-marketing, or more narrowly so it only prohibits such reliance in the member state where pre-marketing has taken place and only in relation to those investors contacted as part of the pre-marketing. Further guidance is required from the European Commission, ESMA² and local regulators on this point.

NOTIFICATIONS FOR COMMENCING AND CEASING MARKETING

The CBDF requires that an EU manager send within two weeks of having commenced pre-marketing, a notification to its home member state regulator. The notification should specify the member states and the periods during which the pre-marketing is taking or has taken place and a brief description of the pre-marketing, including information on the investment strategies presented.

² The European Securities and Markets Authority

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It should be noted that the pre-marketing notification is distinct from the AIFMD notification procedure required in order to make use of the AIFMD marketing passport.

The CBDF also requires that where an EU AIFM ceases marketing in a particular member state, it must submit a de-notification filing in its home member state and the EU AIFM is prohibited from pre-marketing that AIF or “similar investment strategies or investment ideas” in that member state for a period of 36 months. This may result in some managers preferring not to “de-notify” a fund if that will limit future fund raises—even though that may mean such fund continues to accrue costs to the relevant regulator in respect of such funds.

MARKETING COMMUNICATIONS

ESMA has produced guidelines pursuant to the CBDF Regulation “*The ESMA final report on guidelines on marketing communications under the Regulation on cross-border distribution of funds dated 27 May 2021*” (the “Guidelines”). These require EU managers to ensure that all marketing communications addressed to investors in the EU are, amongst other things, identifiable as marketing communications, describe the risks and rewards of investing in an AIF in an equally prominent manner and contain information that is fair, clear and not misleading.

The Guidelines contain specific requirements for marketing communications, including disclaimers that must be used, rules regarding the presentation of information on costs, information on past performance and expected future performance.

EU AIFMs are required to ensure compliance with both the high-level principles and the more prescriptive requirements of the Guidelines. Non-EU AIFMs may be subject to the Guidelines if member states decide to draft equivalent rules so the Guidelines apply to non-EU AIFMs too. Even if such guidelines are not applicable to non-EU managers, they may choose to apply such guidelines as best practice in any case.

The Guidelines will become applicable six months after their publication in all EU languages, i.e. this will be in 2022.

IMPLEMENTATION IN EU MEMBER STATES

As the CBDF Directive is not directly applicable in member states and requires national legislation in each case there may be variation in how the rules are implemented and applied in each member state. In particular this is likely to be the case as it relates to how the CBDF will apply to non-EU AIFMs. Although as stated above non-EU AIFMs are not in scope, Recital (12) of the CBDF Directive states:

National laws, regulations and administrative provisions necessary to comply with [the AIFMD] and, in particular, with harmonised rules on pre-marketing, should not in any way disadvantage EU AIFMs vis-à-vis non-EU AIFMs. This

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concerns both the current situation in which non-EU AIFMs do not have passporting rights, and a situation in which the provisions on such passporting in [the AIFMD] become applicable.

Therefore, it will be for each member state to determine how its local implementation will not disadvantage EU AIFMs.

In France, there is a pre-marketing regime available to non-EU AIFMs, which is an exception to the marketing regime. In other words, the practice which, for non-EU AIFMs or third parties acting on their behalf, consists of contacting up to fifty investors in order to estimate their level of interest before launching an AIF in France was not considered as marketing by the French regulator, the AMF. In line with its historical position, the AMF applying the rules of CBDF to non-EU AIFMs. However, the practical difficulties of registering a non-EU fund with a non-EU AIFM for marketing in France remain.

In Germany, the CBDF will apply to non-EU AIFMs in a similar way as it applies to EU AIFMs.

In Luxembourg, no gold-plating is foreseen but it remains uncertain whether non-EU AIFMs engaging in pre-marketing activities will be required to comply with requirements similar to those of EU AIFMs. It also appears unlikely that there will be any gold-plating in the Netherlands.

As the UK is no longer an EU member state it will not be implementing the CBDF, and non-UK AIFMs wishing to market their funds in the UK will need to comply with the existing rules as set out in the FCA Handbook and the UK NPPR.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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