



Enhancing the cross-border distribution of collective investment funds

March 2018

New European regulatory proposals

The European Commission has published a draft [Regulation](#) and [Directive](#) on the cross-border distribution of investment funds. The aim is to establish a genuine internal capital market by addressing fragmentation and removing regulatory barriers (namely Member States' marketing requirements, regulatory fees and notification and administrative requirements), which can all prevent the cross-border distribution of investment funds in the European Union.

Current regulatory status – overview

Investment funds are currently regulated by two main pieces of EU legislation; the Directive on Undertakings for Collective Investments in Transferable Securities (UCITS) and the Directive on Alternative Investment Fund Managers (AIFMD). The AIFMD regulates managers of alternative investment funds (AIFs).

The purpose of the Commission's proposals are therefore to supplement and, where necessary, amend the UCITS Directive and AIFMD to eliminate current regulatory barriers to the cross-border distribution of investment funds in order to enable a better functioning European single market.

The Commission's proposals

In summary, the proposed Regulation seeks to improve transparency by aligning national marketing requirements and regulatory fees across the EU. The procedure for

the verification of marketing material by national competent authorities will also be harmonised. Enhanced reporting to the European Securities and Markets Authority (ESMA) allows for greater monitoring and supervision at a supra-national level.

The proposed reforms have a broad application and will apply to **all** asset managers. The intention is to assist smaller asset managers raising capital on a cross-border basis as well as providing larger managers access to more European markets.

The key changes introduced by the Regulation include:

- marketing communications must be identifiable as such and identify the risks and rewards of investing in the UCITS or AIF
- competent authorities (the Financial Conduct Authority (FCA) in the UK) must publish on their websites all

Any comments or queries?

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applicable national laws, regulations and administrative provisions governing the marketing of UCITS and AIFs. ESMA will collate and maintain a dedicated central database containing this information

- fees or charges imposed by competent authorities in relation to the marketing of UCITS or AIFs must be proportionate to the supervisory tasks carried out by the competent authority
- ESMA will publish and maintain a centralised database of all managers of AIFs (AIFM), UCITS management companies, AIFs and UCITS, and
- the Regulation amends the EuVECA Regulation¹ and the EuSEF Regulation² to allow managers registered under these to assess investor appetite for investment opportunities through the introduction of a defined concept of pre-marketing (discussed further below).

The proposed Directive, which accompanies the Regulation, amends the AIFMD and introduces the following key changes:

- a new concept of pre-marketing of AIFs by an AIFM, which permits an AIFM to test an investment idea or investment strategy with professional investors. However, the AIFM may not promote or market an established AIF without notification to the competent authority
- an AIFM may only notify a competent authority of the cessation of marketing of an AIF in certain limited circumstances, and
- to the extent the AIF may be marketed to retail investors in a given Member State, the AIFM is required to make facilities available to retail investors to facilitate situations such as subscriptions, payments and redemptions of units to ensure the consistent treatment of retail investors.

Initial industry reactions to the Commission's proposals

Industry trade bodies have not welcomed the proposals. The European Fund and Asset Management Association (EFAMA) has [warned](#) that the proposals can act as

an additional barrier rather than facilitating cross border fund distribution by imposing an additional layer of regulatory requirements.

ICI Global also views the reforms as falling short of removing barriers to cross-border distribution of investment funds. Their initial response to the Commission's proposal can be found [here](#). Specifically, ICI Global will seek to engage with the Commission to "improve the proposal with regard to the pre-marketing regime, creation of a pan-EU private placement regime, and required notifications for cross-border fund marketing".

Focus on marketing and the introduction of pre-marketing in the context of AIFMD

The background to the proposed amendments to the marketing provisions in the AIFMD are characterised by divergent implementation of the marketing rules in different member states. Such variations in implementation create barriers to the cross-border distribution of funds.

Marketing – the FCA's current stance

The FCA has previously pointed out that neither the Commission nor ESMA has so far provided guidance on the meaning of "marketing" in the context of AIFMD. The FCA has given [guidance](#) on the meaning and has concluded that the view of the FCA is, in summary, any communication with a potential investor relating to draft documentation does not constitute marketing. Further, before a fund manager can apply for a marketing permission, the fund documentation must be in materially final form. The FCA acknowledges in its guidance that other EEA States may form a different interpretation of what constitutes marketing.

The consequence of the FCA's stance is that negotiating the fund documentation (for example in the context of closed ended private equity funds, the limited partnership agreement and any side letter) with investors is all conducted prior to the marketing of the fund. The marketing takes place when the

1. Regulation (EU) No 345/2013 on European venture capital funds.
2. Regulation (EU) No 346/2013 on European social entrepreneurship funds.

documents are in materially final form and manager has had its application to market the AIF approved by the FCA³.

To date, the UK fund management industry has welcomed the FCA's pragmatic approach to marketing for the purposes of AIFMD.

The Commission's new approach to pre-marketing

In its proposed Directive, the Commission correctly identifies that divergent regulatory and supervisory approaches concerning the cross-border distribution of AIFs cause market fragmentation and barriers to cross-border marketing and access to AIFs.

To address these concerns, the Directive introduces a novel concept of "pre-marketing"⁴ to the AIFMD landscape and amends the AIFMD to set out the conditions for an EEA fund manager to be permitted to conduct pre-marketing activities in the EEA.

Pre-marketing is defined as the direct or indirect provision of information in investment strategies or investment ideas by an AIFM or on its behalf to professional investors domiciled or registered in the EEA in order to test their interest in an AIF which is not yet established.

Managers may engage in pre-marketing except in circumstances where the proposal:

- relates to an established AIF
- contains reference to an established AIF
- enables investors to commit to acquiring units or shares in a particular AIF, or
- amounts to a prospectus, constitutional documents of a not-yet-established AIF, offering documents, subscription forms or similar documents **whether in a draft or a final form** allowing investors to take an investment decision.

There is no obligation on an AIFM to notify the competent authority of pre-marketing activities. However, subscription by professional investors in an AIF established

following the pre-marketing or in an AIF managed or marketed by an EU AIFM that had engaged in pre-marketing of a not-yet-established AIF with similar features shall be "considered the result of marketing" and would therefore require approval by the competent authority.

Reverse solicitation

It is worth noting that reverse solicitation (which should always be treated with care by managers) is not affected by the Commission's proposals. True reverse solicitation is not caught by the AIFMD and there is no requirement for an application to the competent authority. However, it should also be noted that reverse solicitation is (to some extent) subject to the same definition-related issues as marketing; different national regulators consider different scenarios to fall within the ambit of reverse solicitation. Nevertheless, the proposed reforms may cause managers to turn to reverse solicitation where they would previously have been more willing to seek a marketing approval from the competent authority thereby harming the Commission's ambitions to remove barriers and create a genuine internal capital markets union.

Concluding remarks

The Commission's efforts to remove barriers to cross-border fund distribution are laudable. However, we note the short time-frame for implementation as the Commission's intention is to have the legislation in force before the European Parliament elections in May 2019. Accordingly, the Commission deadline for responses to the proposed legislation is 7 May 2018.

The proposals for a new ESMA database are a welcome addition and should enable ESMA to conduct a greater degree of compliance supervision and oversight. Clearly much of the detail concerning implementation, the reporting obligations between competent authorities and ESMA and issues around the enforcement of reporting requirements remain to be determined but the general

3. Art 31 AIFMD, Directive 2011/61/ EU.
4. Art 2 of the proposed Directive amends the AIFMD by introducing a definition of "pre-marketing" and new Art 30(a) – "Conditions for pre-marketing in the Union by an EU AIFM".

approach should assist the removal of barriers to cross-border distribution. Consistency of information across Europe will be key to ensuring a genuine internal capital markets union.

Fees and charges needing to be proportional to the oversight offered are a welcome addition as is the requirement that marketing documentation accurately identifies the risks and rewards of the proposed investment.

The reverse solicitation rules, which so many managers rely on, will not be affected by the proposed reforms. Perhaps the Commission should have taken the opportunity to clarify the scope of reverse solicitation. Then again, perhaps had it done so it would have been at odds with some less restrictive regimes.

The FCA's current pragmatic approach as to when a manager must seek a marketing notification, which some might already regard as an "outlier", and even the interpretation taken by certain other European competent authorities, may need to be re-assessed in light of the Commission's proposals.

On balance, however, clarification of the grey areas surrounding pre-marketing and a manager's initial discussions and even negotiations with potential investors should be regarded as a step in the right direction.

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