# Fried Frank
# Ongoing Issues for U.S. Fund Managers Marketing in Europe

## *FIA L&C Webinar Series*

## *July 2016*

David Mitchell
Partner
David.Mitchell@friedfrank.com
Tel: +1 212 859 8292

Fried, Frank, Harris, Shriver & Jacobson LLP
One New York Plaza, New York, NY 10004

Gregg Beechey
Partner
Gregg.Beechey@friedfrank.com
Tel: +44 (0) 20 7972 9172

Fried, Frank, Harris, Shriver & Jacobson (London) LLP
41 Lothbury, London EC2R 7HF UK

William Breslin
Partner
William.Breslin@friedfrank.com
Tel: +1 202 639 7051

Fried, Frank, Harris, Shriver & Jacobson LLP
801 17th Street, NW Washington, DC 20006

# Upcoming L&C Webinars and Events

**Additional webinars will be planned for Fall 2016. Visit FIA.org/lc for the latest information.**

**Save the Date: 39th Annual FIA Law & Compliance Conference**
May 3-5, 2017 | Omni Shoreham Hotel | Washington, DC

# Administrative Items

The webinar will be recorded and posted to the FIA website following the conclusion of the live webinar.

A question and answer period will conclude the presentation.

- Please use the “question” function on your webinar control panel to ask a question to the moderator or speakers. Questions will be answered at the conclusion of the webinar.

CLE certificates will be emailed shortly after conclusion of the webinar.

# Presentation Outline

- AIFMD Overview:
  - what is the AIFMD?
  - key concepts
  - why are U.S. Fund Managers in scope?
- Options for U.S. Fund Managers marketing in the EU:
  - establishing a parallel EU Fund (EU AIF + EU AIFM)
  - using a third party AIFM
  - national private placement regimes
  - reverse solicitation?
- One to watch: the third country passport
- CFTC regulatory and compliance issues
- Annex: NPPR Summary Table

# AIFMD OVERVIEW

# What is the AIFMD?

- A package of European legislative measures which came into effect on 22 July 2013, which govern the way alternative investment funds ("AIFs") are managed and/or marketed in the European Union ("EU")
- AIFMD comprises, in part, a European directive (2011/61/EU). European directives have to be implemented locally by each EU Member State and certain Member States have "gold plated" AIFMD requirements (meaning there is variation across the EU)
- AIFMD regulates the manager of alternative investment funds ("AIFMs"), not the fund vehicle
- Since July 2014, non-EU managers have had to comply with certain AIFMD rules and procedures to the extent that they wish to access European investors through marketing in the EU

# Key Concepts

**"AIF" (alternative investment fund)**

- Defined as a:
  - collective investment undertaking (other than a UCITS fund)
  - which raises capital from a number of investors
  - invests capital in accordance with a defined investment policy, for the benefit of those investors
- An AIF may be open or closed ended. No further requirements as to form (may be constituted as a company, a trust, under a contract or a statute etc) and the investment strategy is irrelevant
- Specific exclusions available: segregated managed accounts, family offices, joint ventures, holding companies, employee participation schemes. Case-by-case analysis required. A single investor vehicle will not be an AIF

**"AIFM" (alternative investment fund manager)**

- Every AIF must have single AIFM (internal or external)
- The AIFM is the legal person appointed by or on behalf of the AIF who is responsible for "managing" the AIF
- "Managing" the AIF means providing:
  - portfolio management; **and**
  - risk management to the AIF
- AIFM must not be a "letter box entity" (which creates issues around delegation)

# Why are U.S. Fund Managers In Scope?

- AIFMD applies not only to alternative investment fund managers ("AIFMs") established in the EU, but non-EU AIFMs "marketing" AIFs (non-EU or EU) to investors in the EU
- "Marketing":
  - is defined as "*a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union*"
  - therefore excludes marketing at the own initiative of the investor (i.e. reverse solicitation)
- Whether or not a non-US manager is subject to AIFMD (by virtue of it marketing in the EU) will need to be assessed on a vehicle by vehicle basis
- E.g., where a Delaware Manager (AIFM) manages both Delaware and Cayman LPs:
  - offering of Delaware LP interests to U.S. investors = AIFM not in scope
  - offering of Cayman LP interests to UK investors = AIFM in scope and obliged to comply with AIFMD in respect of the Cayman LP only. Cayman LP would need to be registered for marketing

# OPTIONS FOR U.S. FUND MANAGERS MARKETING AN AIF IN THE EU



FIA

# Establishing a Parallel EU fund (EU AIF + EU AIFM)

## Advantages

- Able to obtain EU marketing and management passport relatively quickly (one month notification period), BUT
  - subject to formal regulatory processes, involving pre-approval of fund documents
  - AIF needs to be established in the EU to qualify
- Gives maximum flexibility to the IR Team
- Possible reputational benefits/investor preference (but opinions differ)

## Disadvantages

- Establishment costs
- Substance requirements
- Subject to full AIFMD compliance eg.
  - remuneration rules
  - regulatory capital
  - insurance
  - depository
  - restructuring of organisation/personnel
- Time delay (6 months for AIFM authorisation in UK)
- Potential irrecoverable VAT
- Impact on investment management process e.g. leverage limits, liquidity management, due diligence, best execution, portfolio company reporting and “asset stripping” restrictions

# Using a Third Party AIFM

**Advantages**

- Speed to market
- Certain cost savings (cf. establishing an EU AIFM)
- Substance requirements fall away
- Third party AIFM becomes responsible to regulators for compliance
- Third party AIFMs claim to offer established distribution networks
- Can be used as a temporary solution (e.g., if you are in the process of establishing a presence in an EU Member State)
- Most third party AIFMs will be unobtrusive

**Disadvantages**

- Costs
- Loss of control by US manager to third party AIFM
- Still subject to disclosure requirements
- May lose freedom to choose service providers
- Risk of challenge by regulators (letterbox test)
- Delegation of portfolio management by the third party AIFM to the US manager may cause AIFMD remuneration rules to apply to the US manager (although an advisory arrangement would not have this effect)

# National Private Placement Regimes ("NPPR") (Article 42 AIFMD)

- AIFM submits NPPR notifications/applications in each Member State they wish to market in
- Placing agent cannot market if AIFM cannot

**Advantages**

- Only need to comply with certain provisions of the AIFMD:
  - pre-investment disclosures
  - annual report and other investor disclosures
  - reporting to regulators
  - "asset stripping" rules
- Relatively low costs (cf. establishing an EU AIFM)
- A sensible route where only seeking to market to investors in a select few European jurisdictions

**Disadvantages**

- Inconsistent rules across EU – easy in some, difficult in others
- Still subject to disclosure requirements toward European investors
- Medium term uncertainty on marketing scope and future changes
- Possibly some restructuring of organisation/personnel required
- Only an option if:
  - NPPR rules allow
  - supervisory co-operation agreements in place
  - not FATF blacklisted
- France and Italy inaccessible

# Reverse Solicitation?

## Advantages

- Does not constitute “marketing” so no compliance obligations under AIFMD
- Not uncommon (entire funds have been raised using reverse solicitation)

## Disadvantages

- What amounts to reverse solicitation varies from one member state to another
- Very little regulatory guidance
- Open to challenge by local regulators

# How to Identify the Best Way Forward for You

- Decide whether you wish, or are obliged, to be:
  - within the main scope of the AIFMD; or
  - outside the main scope of the AIFMD (for so long as private placement regimes are available in key EEA Member States)
- In order to do so:
  - identify potential AIF and AIFM
  - consider substance and activities of your management entities inside and outside the EEA
  - identify where in the EEA it is essential to be able to market

- NPPRs are often seen as complicated by US managers but may be relatively straightforward, depending on where your investors are based

# ONE TO WATCH: THE "THIRD COUNTRY PASSPORT"

# The “Third Country Passport”

- AIFMD contains a provision (not currently in force) which would allow non-EU managers to access the European marketing passport (the “Third Country Passport”) and thereby market their funds across the EU (including those countries impossible to access under NPPR) with one month’s notice
- The trade off is that the non-EU manager would have to comply with AIFMD in full. There are therefore mixed views on whether NPPR is preferable (although there may not always be a choice)
- The Third Country Passport is not yet available and will only become active if:
  - ESMA advises the EC that activating the passport is appropriate - country-by-country assessments are currently ongoing, with advice expected 30 June 2016....
  - the country where the AIF is established (e.g. US/Cayman):
    - has a co-operation arrangement in place with the competent authority of the AIFM’s “Member State of Reference”;
    - is not listed as a non-cooperative country and territory by FATF; and
    - has signed an OECD compliant tax agreement with the Member State of reference
- In July 2015, ESMA advised the Commission it could not support the extension of the passport to the US (amongst others) at that time. Further work is ongoing at the time of writing

# CFTC REGULATORY AND COMPLIANCE ISSUES

# CFTC Regulatory and Compliance Issues

- Like AIFMD, the Commodity Futures Trading Commission ("CFTC") regulates the managers of funds, not the fund vehicle, pursuant to the US Commodity Exchange Act ("CEA") and the rules and regulations thereunder.

- The CFTC interprets the provisions of the CEA and its rules and regulations to have extraterritorial effect, so that they are not limited exclusively to the activities of fund managers in the US.

# CFTC Registration Requirements

- Depending upon the nature and scope of its activities, CFTC registration and related disclosure, reporting (including regulatory reporting) and recordkeeping requirements for commodity pool operators ("CPOs") and for commodity trading advisors ("CTAs") may apply to the AIFM. This is so even if the US manager is already registered and complying with these requirements or with an appropriate exemption.
- This analysis also will look at factors such as the location of the AIFM and whether the AIF is marketed to US investors.
- If required to register as a CPO or CTA under applicable CFTC and National Futures Association rules, the AIFM may be subject to a suite of potentially duplicative, overlapping or conflicting regulatory requirements.
- In general, there is no provision under which an AIFM may apply for a "comparability" determination that would enable it to satisfy CFTC and NFA requirements under a "substituted compliance" approach (i.e., by complying with corresponding EU requirements).

# Delegation of CPO Functions

- If it is required to be registered as a CPO, the AIFM may seek to delegate its functions to a registered CPO. If so, the criteria of CFTC Letter No. 14-126 (October 15, 2014) must be satisfied in order for the AIFM to be eligible for self-executing CPO registration no-action relief.
- In summary, the relevant criteria in such circumstances are as follows:
  - the AIFM (the "Delegating CPO") has delegated to a registered CPO (the "Designated CPO") all of its investment management authority with respect to the AIF, i.e., the pool at issue;
  - the Delegating CPO does not participate in the solicitation of participants for the pool;
  - the Delegating CPO does not manage any property of the pool;
  - the Designated CPO is registered as a CPO;
  - the Delegating CPO is not subject to a "Statutory Disqualification" as defined;
  - there is a business purpose for the Designated CPO being a separate entity from the Delegating CPO that is not solely to avoid registration by the Delegating CPO under the CEA and CFTC rules;
  - the books and records of the Delegating CPO with respect to the pool are maintained by the Designated CPO.
- If the Delegating CPO and the Designated CPO are each a non-natural person, one such CPO controls, is controlled by, or is under common control with the other CPO.

# Delegation of CPO Functions (cont'd)

- Assuming the Delegating CPO (i.e., the AIFM) is a non-natural person, then the Delegating CPO and the Designated CPO must each undertake to be jointly and severally liable for any violation of the CEA or the CFTC's rules by the other in connection with the pool's operation.

Certain of these criteria may be problematic in which case a request for bespoke no-action relief may need to be submitted to the CFTC staff. For example, a fund manager may hire a non-natural person third party AIFM to act as the fund's AIFM, but even if that third party is registered as a CPO, it would not be under common control with the fund manager.

# ANNEX: NPPR SUMMARY TABLE

# AIFMD - Offshore Funds

Marketing Offshore funds in Europe under National Private Placement Regimes ("NPPRs")

*** Indicates that restrictions apply only within the jurisdiction**

| Country | NPPR | Key NPPR requirements | Pre-Marketing? | Reverse solicitation? |
|---|---|---|---|---|
| **Austria*** | Yes | • Detailed application<br>• Appointment for depositary functions<br>• Austrian Legal Representative (non EU AIFMs)<br>• Notification in German or English<br>• €4,500 fee<br>• Approval can take up to four months<br>• Marketing must not commence until approval has been given | • Possible<br>• "Offering" requires sufficiently detailed information for investor to make investment decision<br>• Pre-marketing should include appropriate disclaimer language that no subscriptions from Austrian investors would be accepted until the notification procedure is completed in Austria | • Possible<br>• Investor should have contacted the manager or marketer at their offices outside of Austria and any subsequent dealings should occur outside of Austria |
| **Belgium** | Yes | • Notification to FSMA<br>• May only start marketing, once the FSMA has confirmed the notification (usually three to four weeks after the filing) | • Pre-marketing activities generally do not trigger NPPR notification requirements<br>• Key considerations in determining whether activities fall within pre-marketing are whether the offering documents are final and complete and whether it is possible for investors to subscribe for interests on the basis of those documents<br>• Communications intended to gauge the interest of potential investors without any completed documents (eg.draft PPMs or teaser documents) should not constitute "marketing" | • Prohibited unless falls within a safe harbour |
| **Denmark*** | Yes | • DKK5,000 Annual Fee (€670)<br>• Detailed application<br>• Depositary must be appointed fulfilling the 'depositary lite' functions<br>• Up to 3 month process<br>• Reciprocity statement from fund's home authority or counsel in fund's jurisdiction (depending on the circumstances)<br>• Statement on marketing in fund's jurisdiction<br>• Original documents required for submission | • Possible<br>• Initial meetings with potential investors prior to establishment of the fund do not constitute marketing if there is no offering documentation in place and investors are unable to commit to an investment | • Possible but Danish FSA take very strict approach<br>• A confirmation from the investor should be procured to document the reverse solicitation<br>• Any pre-marketing will void the possibility of reverse solicitation |

# AIFMD - Offshore Funds

Marketing Offshore funds in Europe under National Private Placement Regimes ("NPPRs")

| Country | NPPR | Key NPPR requirements | Pre-Marketing? | Reverse solicitation? |
|---|---|---|---|---|
| **Finland** | Yes | • Detailed application<br>• No official form of application; letter of notification from local counsel required<br>• €2,600 fee<br>• Marketing may only commence once approval is received<br>• No official time limit for approval to be given | • Not clearly defined in legislation, but discussions with regulator suggest it is possible<br>• Activities not aimed at securing investment (e.g. roadshows where no actual offer to buy or sell units is made) will be considered pre-marketing | • Possible, but very little guidance regarding scope<br>• Generally, interpreted very narrowly<br>• Information provided to an investor as a result of reverse solicitation should be limited to information specifically requested by the investor |
| **France*** | No | • Authorisation by the AMF and full compliance with AIFMD | • No guidance produced | • Reverse solicitation possible<br>• Strict requirements: marketing must be in response to client's unsolicited request to purchase shares in a specific fund |
| **Germany** | Yes | • Very detailed application (including detailed (possibly sensitive) information regarding the Depositary)<br>• Depositary must be appointed fulfilling 'depositary lite' functions<br>• Depositary Agreement to be enclosed with application<br>• BaFin must issue a marketing clearance before marketing may begin<br>• 2 month process (can be extended)<br>• €6,582 fee | • Pre-marketing if fund is not advertised under a specific name or its offering documents are not ready to be signed and made available to prospective investors<br>• Tread carefully. Conservative interpretation of guidance suggests that pre-marketing is only possible before the fund is in existence and the fund documents are not final | • Possible but scope is unclear in private equity context<br>• Treat carefully and ensure there is a paper trail to evidence reverse solicitation |
| **Ireland** | Yes | • Notification procedure<br>• Marketing may not commence until approval from the Central Bank has been granted<br>• Central Bank will normally take 5 working days to process application | • No guidance produced, so there is no concept of pre-marketing<br>• Communications would need to be analysed on a case by case basis | • No guidance produced<br>• Central Bank has expressed scepticism about reverse solicitation in an Irish context |

The table above is intended to give a snapshot and is subject to assumptions as to the fund structure, jurisdiction and target investors. Detailed advice is required prior to marketing.

# AIFMD - Offshore Funds

Marketing Offshore funds in Europe under National Private Placement Regimes ("NPPRs")

| Country | NPPR | Key NPPR requirements | Pre-Marketing? | Reverse solicitation? |
|---|---|---|---|---|
| **Italy*** | No | • Bank of Italy authorisation<br>• Currently no private placement regime<br>• Likely to be subject to an annual fee | • N/A | • Possible but treat carefully<br>• Marketing may also be directed at Italian investors outside of Italy<br>• Records should be kept of all communications with Italian investors to show that they were initiated by the investor or took place outside of Italy<br>• The more Italian investors are targeted, the harder it will be to make the reverse solicitation argument |
| **Luxembourg** | Yes | • Notification required<br>• No requirements over and above Article 42<br>• An AIFM may market the AIF on the basis of final form documents provided that no subscription may become effective until the NPPR notification is made | • CSSF guidance states that an AIFM providing draft documents to prospective investors does not constitute marketing if the investors cannot use the documents to formally subscribe for interests | • Possible. According to the CSSF, the cumulative components of reverse solicitation are:<br>o The investor has approached the AIFM on its own initiative with the intention of investing in (or, initially, receiving information regarding) AIF(s) managed by the AIFM<br>o Neither the AIFM, nor the AIF (nor any intermediary on their behalf) has solicited the investor to invest<br>• The burden of proof falls on the AIFM. Evidence could be produced by means of written confirmation by the investor that he/she has decided on his/her own initiative to invest in (or, initially, request information regarding the AIF)<br>• The CSSF states that reverse solicitation may not be relied upon where the AIFM has provided prospective investors with draft documents under the premise of pre-marketing |
| **Netherlands *** | Yes | • Notification procedure<br>• Simple notification for Guernsey, Jersey or US AIFMs, 8 week process, €1,500 fee<br>• More detailed for other AIFMs, longer, €5,000 fee<br>• Marketing to qualified investors may begin as soon as NPPR notification is received by AFM | • Possible<br>• Needs to be an offer of units in the Netherlands to be caught by legislation<br>• An offer must be specific as to characteristics of AIF (e.g. price, rights, time, place etc.). 'Pre-marketing' that does not have this characteristic should not be caught<br>• Indicators of being 'in the Netherlands' include: material in Dutch, sending material directly to residents of the Netherlands, providing information of Dutch fiscal aspects of AIF, mentioning contact people in the Netherlands | • Possible<br>• If an investor resides in the Netherlands and takes the initiative to approach an AIFM which is outside of the Netherlands, then no marketing is considered to have been made |

# AIFMD - Offshore Funds

Marketing Offshore funds in Europe under National Private Placement Regimes ("NPPRs")

| Country | NPPR | Key NPPR requirements | Pre-Marketing? | Reverse solicitation? |
|---|---|---|---|---|
| **Norway*** | Yes | • No regulatory fee<br>• Application for approval/registration<br>• Norwegian investor payment arrangements<br>• 2 weeks to 6 months | • Possible<br>• "Marketing" is only deemed to have taken place when documentation is provided on the basis of which investment can be undertaken | • N/A<br>• Instead of reverse solicitation, Norwegian regulation focuses on whether the marketing takes place in Norway (i.e. materials are sent to Norway or marketing materials are personalised for Norwegian investors) |
| **Spain** | Yes | • Notification to regulator (CNMV)<br>• Depositary must be identified | • No guidance as to pre-marketing<br>• 'Marketing' is defined in legislation as the acquisition of clients through an advertising activity, i.e. any form of communication addressed to potential investors in order to promote the subscription or acquisition of shares in the fund | • No guidance |
| **Sweden*** | Yes | • SEK 15,000 (€1,620) fee<br>• No notification form available. Foreign counsel will draft cover letter<br>• 60 day process | • Marketing prior to 1st close permissible<br>• Pre-marketing following 1st close unclear | • Possible<br>• No clear rules as to when it would apply |

The table above is intended to give a snapshot and is subject to assumptions as to the fund structure, jurisdiction and target investors. Detailed advice is required prior to marketing.

# AIFMD - Offshore Funds

Marketing Offshore funds in Europe under National Private Placement Regimes ("NPPRs")

| Country | NPPR | Key NPPR requirements | Pre-Marketing? | Reverse solicitation? |
|---|---|---|---|---|
| **Switzerland** | No | • If placement is only directed as qualified investors then no regulatory approval is required<br>• But local representative and paying agent must be appointed<br>• Fund documentation must contain details of local representative, paying agent and the location of relevant documents of the fund as well as annual and half-yearly reports<br>• No regulatory approval required for placements directed as super-qualified investors (banks, securities dealers, fund management companies, asset managers of CISs, central banks or regulated insurances companies) | • Possible but treat carefully<br>• Any marketing aiming at the subscription for a specific fund will fall foul of distribution rules | • Possible<br>• Limited to situations where investors request information about a specific fund before any contact from the fund manager or a promoter |
| **UK*** | Yes | • £250 initial fee, £500 annual fee<br>• Simple notification (no enclosures required)<br>• Marketing may begin upon submission | • Pre-marketing is possible before interests in the fund are made available for investment<br>• Detailed rules under the UK financial promotions regime apply in addition to AIFMD marketing rules. | • Possible but treat carefully<br>• Should obtain confirmation from the investor that the offer was at its initiative. This is normally sufficient to prove reverse solicitation |

The table above is intended to give a snapshot and is subject to assumptions as to the fund structure, jurisdiction and target investors. Detailed advice is required prior to marketing.

# Questions?

**Please use the "question" function on your webinar control panel to ask a question to the moderator or speakers.**

**For more information please contact:**

David Mitchell: David.Mitchell@friedfrank.com

Gregg Beechey, Gregg.Beechey@friedfrank.com

William Breslin, William.Breslin@friedfrank.com

FIA