

Cross-border marketing of AIFs and UCITS - European Commission proposes rule changes

The European Commission has published proposals to change a number of the rules governing the cross-border distribution of alternative investment funds and undertakings for collective investment in transferable securities. The proposed introduction of rules on pre-marketing of funds, in particular, may result in some (presumably, unintended) difficulties for EU alternative investment fund managers (AIFMs) - this will need to be watched carefully as the proposals are considered by the Council of the EU and the European Parliament.

Submitted	13 March 2018
Applicable Law	European Union , European Economic Area (EEA)
Topic	Asset Management > Hedge funds, Private equity funds, Real estate funds Investment Bank Regulatory Private Funds
Sector Focus	Asset Management and Investment Funds
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Introduction

On 12 March 2018, the European Commission (Commission) published proposals to change a number of the rules governing the cross-border distribution of alternative investment funds (AIFs) and undertakings for collective investment in transferable securities (UCITS). The changes are an attempt to bring greater clarity and harmonisation to cross-border marketing (a) between the UCITS and Alternative Investment Fund Managers Directive (AIFMD) regimes and (b) between certain practices adopted by Member States. They also show again the increasing role of ESMA in policing the regulatory behaviour not just of asset managers but also of the national competent authorities (NCAs) themselves. The proposed introduction of rules on pre-marketing of funds, in particular, may result in some (presumably, unintended) difficulties for EU alternative investment fund managers (AIFMs) - this will need to be watched carefully as the proposals are considered by the Council of the EU and the European Parliament.

This Note examines the proposals put forward by the Commission to amend certain marketing provisions in the AIFMD and the UCITS Directive. [See our separate note which examines the changes through the perspective, primarily, of the UCITS Directive.](#)

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Executive summary

As a result of its work on seeking to build an efficient capital markets union, the Commission notes that a number of barriers exist to the efficient cross-border marketing of investment funds throughout the EU. It has, therefore, now proposed a number of changes to AIFMD and the UCITS Directive, aimed at ensuring that various marketing provisions in these directives are aligned, regardless of whether the type of fund being marketed is an AIF or a UCITS.

The changes are contained in two proposed texts, one in the form of a [Directive](#), the other a [Regulation](#), and are aimed primarily at UCITS management companies (ManCos) and AIFMs (together referred to as "managers", where applicable, for the purposes of this Note).

The proposals represent a fairly targeted attempt by the Commission to introduce greater consistency between the EU's investment fund regimes - it is not a comprehensive attempt to update AIFMD generally (for example, by extending certain MiFID2 requirements to AIFMs) nor does it take forward the possible extension of the managing or marketing passports to non-EU AIFMs and the consequential switching off of national private placement regimes (NPPRs).

The Directive puts forward changes which include:

- the introduction of a definition of "pre-marketing" under AIFMD, to allow "authorised EU" AIFMs to sound out professional investor interest in a possible AIF without triggering AIFMD notification requirements. If, however, a professional investor later subscribes to the AIF when established (or an AIF managed by the AIFM with "similar features"), this would be considered to have been the result of marketing.

As the Commission's proposals go through the process of being considered and amended by the Council of the EU and the European Parliament, it will be necessary to watch carefully how this provision evolves since it could, as drafted, potentially make it more difficult for an EU AIFM to rely on reverse enquiry.

It will also be important to see what impact the proposed definition of "pre-marketing" (which would preclude the use of "offering documents, subscription forms or similar documents whether in a draft or a final form") might have on the interpretation of the definition in AIFMD of "marketing" in those EU Member States which currently do not consider the sending of draft documentation to potential investors to fall within the latter definition.

- the introduction of local facilities, for AIFs being sold to retail investors, along the lines of those currently required

by the UCITS Directive (with the rules for both fund regimes being brought up to date to allow the facilities to be provided on line)

- harmonisation of the procedures that a UCITS ManCo or an EU AIFM should take when it wishes to discontinue marketing, respectively, a UCITS or an EU AIF in a Member State other than the manager's home Member State.

The Regulation would require:

- the introduction of requirements on marketing communications to investors, bringing such communications in respect of AIFs into line with those for UCITS, regardless of whether these are aimed at retail or professional investors
- the introduction of harmonisation (and greater transparency) to how a NCA may - if it has such a requirement - perform verification checks of investor communications used when promoting either UCITS or AIFs which are marketed to retail investors
- the online publication by NCAs (and in a central database maintained by ESMA) of:
 - all applicable national laws, regulations and administrative provisions governing marketing rules for UCITS and AIFs and
 - regulatory fees and charges - or the relevant means of calculating these - levied by such authorities under the UCITS Directive or AIFMD.

Although these rule changes (a) seem, on the whole, uncontroversial and (b) will not be in force by the time the UK is expected to leave the EU (and may well only be applicable in the final few months before the end of any transitional period, if one is agreed), the provisions they introduce are likely to be considered a standard for future requirements and a pointer to the Commission's general direction of travel.

Background to the proposals

On 12 March 2018, the Commission formally adopted (ie, published proposed draft texts of) a Directive and a separate Regulation. These look to change a number of the rules governing the cross-border distribution of AIFs and UCITS set out in AIFMD and the UCITS Directive.

The Commission has long been aware that differing marketing requirements, regulatory fees, and notification requirements between EU Member States represent a significant barrier to efficient cross-border fund distribution.

To illustrate this point, the Commission notes that:

- EU investment funds representing 70% of the total AuM are registered for sale only in their own domestic market
- only 37% of UCITS and around 3% of AIFs (presumably the Commission is referring to EU AIFs only) are registered to be marketed in more than three Member States
- although the EU market is smaller than that of the US in terms of AuM, there are almost four times (58,125 as against 15,415) more EU funds - ie, the average EU fund is significantly smaller than its US counterpart, with a consequentially negative impact when it comes to making economies of scale and minimising fees paid by investors.

Following a review, (taken forward through its [Green Paper on Building a Capital Markets Union, Communication on building a Capital Markets Union, Call for Evidence on the EU Regulatory Framework for Financial Services](#) and [public consultation on barriers to cross-border distribution of investment funds](#)), the Commission has now put forward a series of proposals - in the form of the Directive and the separate Regulation.

These proposals are intended to (a) “unlock capital” by making it easier for investors and managers to benefit from the single market and (b) refine certain provisions in the UCITS Directive and AIFMD which had been identified as being burdensome or insufficiently clear (and so allowing for ‘gold plating’ when being transposed into the national law of the different Member States).

The proposals in more detail

The draft Directive

This contains the following provisions:

Pre-marketing under AIFMD

What do the proposals say?

The Directive proposes including a definition of "pre-marketing" in AIFMD, allowing authorised EU AIFMs to provide information to EU professional investors on investment strategies or ideas in order to test the appetite for an AIF which is yet to be established, without the need to notify the relevant NCA. (Pre-marketing to retail investors would presumably be precluded, although the Directive is not explicit on this point.)

The information must not contain any reference to an already established AIF nor include a prospectus or offering document (whether in draft or final form) in respect of an AIF which is yet to be established.

If a professional investor subsequently subscribes to the AIF when established (or another AIF managed by the AIFM which has “similar features”), this would be considered to have been the result of marketing.

We understand that the Commission had originally considered requiring the AIF to have been notified to, or registered with, the NCA of the EU AIFM’s home Member State under either Article 31 or Article 32 of AIFMD as appropriate before the subscription could be accepted. The fact that such a requirement does not appear in the final text is to be welcomed.

(Essentially identical provisions would be extended to cover European Venture Capital Funds (EuVECAs) and European Social Entrepreneurship Funds (EuSEFs).)

Who do they apply to?

While the definition of "pre-marketing" refers to AIFMs generally, the proposed provision itself is limited to "authorised EU AIFMs", so the ability to pre-market would not be extended under the Commission’s proposals to either non-EU AIFMs or to sub-threshold EU AIFMs which have not elected to opt into the full AIFMD regime.

The wording of the proposed new Article 30a does not specify that the AIF concerned must be an EU AIF (which seems logical since pre-marketing is to be permitted only in respect of an AIF before it has been established).

What issues do the proposals raise?

This change seems, on the face of it, to make it easier for an authorised EU AIFM to avoid unwittingly being seen to "market" an AIF under the definition of that term in Article 4 of AIFMD. It may, however, have the opposite (and,

presumably, unintended) effect in practice. Assuming it stays within a given Member State's interpretation of what is, and what is not, reverse enquiry an AIFM is able to remain outside the AIFMD's marketing regime. Under the proposed rule, it would appear that it would no longer be sufficient for the authorised EU AIFM merely to rely on the fact that an enquiry came from the potential investor - rather, it would need to satisfy itself that the enquiry was not the result of the investor having been sent information about the AIF prior to its establishment and that the investor was not looking to invest in a different AIF which has "similar features" to the one on which it had been sent information.

It is also unclear how the definition of "pre-marketing" is intended to interact with existing (and, in some cases, highly divergent) national views on the scope of marketing or, indeed, with the definition of "marketing" set out at Article 4(1)(x) of AIFMD. Would an NCA, such as the UK's FCA, which currently permits draft documents to be circulated (since, in the FCA's view, draft documentation does not constitute "a direct or indirect offering", as referred to in the Article 4(1)(x) definition), be able to maintain its position? On the other hand, it is hard to see how an AIFM could pre-market, in the sense intended by the Commission, in a jurisdiction, such as Sweden, in which the NCA currently takes the view that any promotional mention of a fund constitutes "marketing".

The proposals would appear to create a divergence as to which provisions under AIFMD would apply to EU versus non-EU AIFMs and also to EU versus non-EU AIFs since, by restricting the ability to pre-market to authorised EU AIFMs, these provisions would not apply to non-EU AIFMs marketing or pre-marketing an AIF, unless an NCA chose to extend its Article 42 NPPR to include the same concept.

Changes in relation to local facilities for UCITS and AIFs sold to retail investors

What do the proposals say?

The UCITS Directive requires UCITS ManCos to ensure that, in EU Member States in which a UCITS is sold, it has facilities available for making payments to investors, repurchasing and redeeming units and providing the necessary information to investors. Most Member States have interpreted this to require physical facilities to be made available in their jurisdiction. The proposal, however, provides that Member States shall not require the UCITS ManCo or AIFM to have a physical presence for the purpose of establishing local facilities.

The Commission's proposal, while still requiring that facilities be made available in each Member State where marketing of the UCITS takes place, allows managers to use electronic or other distance communications means to comply.

Further, essentially identical facilities would be required to be made available in respect of AIFs which are marketed to retail investors.

Who do they apply to?

The proposals relating to facilities will apply to all UCITS ManCos and to AIFMs (EU or non-EU) who are marketing to retail investors.

Unlike other provisions in the Directive, this proposal does not appear to be limited to EU AIFs. In consequence, an EU AIFM marketing a non-EU AIF to a retail investor under a NPPR (Article 36 of AIFMD) would need to comply with this provision, as would a non-EU AIFM marketing any AIF to a retail investor under a NPPR (Article 42 of AIFMD).

What issues do the proposals raise?

The requirement to make facilities available to investors has long been in place in respect of UCITS.

The obligation is regarded by many as an anachronism and there was pressure from industry to remove the costly and largely redundant role of the facilities agent in cross-border marketing. The Commission itself regards the existing provisions as "costly" and notes that they fail to take into account the fact that investors now make far greater use of digital technology for such interactions.

In a welcome move, the Commission has proposed to prevent Member States from requiring that local facilities be provided through a physical presence.

This will be a new obligation for AIFMs who market to retail investors, who are likely to find it - as UCITS ManCos already do - a relatively expensive provision with which to comply.

Discontinuing marketing a UCITS or AIF in a host Member State

What do the proposals say?

Essentially identical provisions would be inserted into the UCITS Directive and AIFMD to permit a manager to discontinue the marketing in a given Member State of a UCITS or EU AIF (as applicable) which has a maximum of ten investors in that Member State holding up to 1% of the fund's total AuM.

The manager would also be required to:

- make a blanket offer to repurchase all shares or units held by investors in the Member State in which marketing is to be discontinued. The offer would have to be made public for at least 30 working days, and
- make public by means of a publicly available medium, which is "customary for marketing" an AIF or UCITS and "suitable for a typical" AIF or UCITS investor, its intention to cease its marketing activities in the relevant host Member State.

In such a case, the manager would notify its home NCA. The NCA, in turn, would transmit (within 20 working days of receipt) the notification both to the NCA of the Member State in which marketing is to be discontinued and to ESMA and would inform the manager of such transmission. After this time, the UCITS or AIF must not be marketed in that Member State although all obligations to provide information to investors who remain invested would continue.

Who do they apply to?

Although the text of the proposals refers generally to an "AIFM" and an "AIF", it is clear from the context, as well as from the reference to Article 32 of AIFMD, that it is intended to apply only to EU AIFMs and EU AIFs - presumably, this point will be clarified as part of the legislative process and the wording made consistent with that in Article 32.

What issues do the proposals raise?

Although the proposals themselves seem largely uncontroversial, they introduce an additional element of bureaucracy where one is not, perhaps, required.

Aligning national procedures on certain notifications

What do the proposals say?

An EU AIFM wishing to market an EU AIF in a Member State other than its home Member State must notify its NCA of its intention to do so and provide specified information.

Should there subsequently be a material change to any of the particulars communicated, the NCA in question must inform (a) the AIFM, if it determines that the planned change would mean that the AIFM was not in compliance with AIFMD or (b) the NCA of the host Member State, if the change is acceptable.

Currently, the NCA must inform the AIFM of its decision “without undue delay” where it considers the AIFM should not implement the change or the NCA of the host Member State “without delay” where the change is acceptable.

The Commission proposes to harmonise and clarify these deadlines, which would become “within 20 working days” and “within 1 month” respectively.

Deadlines are similarly proposed in relation where a UCITS ManCo has previously notified its home NCA of its intention to either (a) establish a branch or (b) market a UCITS (in each case in a Member State other than its home Member State) but where there has subsequently been a change in the information provided.

In the case of establishing a branch, the NCA must inform the UCITS ManCo within 10 working days if the change must not be implemented; or, if the change does not affect the UCITS’s compliance with its obligations under the UCITS Directive, the NCA of the home Member State must notify the NCA of the host Member State, again within 10 working days.

In the case of marketing a UCITS, the proposed deadlines are (a) “within 10 working days” and (b) “without undue delay” respectively.

Who do they apply to?

These provisions would apply to UCITS ManCos and to EU AIFMs marketing EU AIFs in Member States other than the AIFM’s home Member State.

What issues do the proposals raise?

The proposals in this area seem uncontroversial and should provide managers with greater certainty as to when they will be informed whether or not the material changes they have notified are acceptable.

The draft Regulation

The Regulation contains the following provisions:

Marketing communications to investors

What do the proposals say?

The proposals are based broadly on the existing provisions under Article 77 of the UCITS Directive (which article is deleted by the Commission’s proposed Directive) and gives them the same direct effect by virtue of being included in

the Regulation (thereby ensuring maximum harmonisation).

The provisions, which apply both to UCITS ManCos and to AIFMs, would require marketing communications to (a) be identifiable as such, (b) be fair, clear and not misleading and (c) present the risks and rewards of purchasing shares or units of an AIF or UCITS in an equally prominent manner.

UCITS ManCos must ensure that all marketing communications indicate that a prospectus exists, that the key investor information document (KIID) is available and where, how and in what language these documents can be obtained. An AIFM would have to comply with similar requirements in respect of an AIF which is required to publish a prospectus or a PRIIPs KID.

ESMA would be mandated to issue guidelines regarding the application of these criteria, taking into account on-line aspects of marketing communications. It would seem reasonable to assume that ESMA's starting point would be Article 44 of the MiFID2 Delegated Regulation, which sets out a detailed statement of what information is required to be included in the context of MiFID business.

In addition, marketing communications must make no statement that contradicts or diminishes the significance of the information contained in the prospectus and the key investor information document (in the case of a UCITS) or of the information which must be disclosed to investors under Article 23 of AIFMD (in the case of an AIF).

Who do they apply to?

These proposals would apply in respect of (a) UCITS ManCos and (b) EU and non-EU AIFMs in relation to EU and non-EU AIFs.

What issues do the proposals raise?

It should be noted that these proposals are not limited to communications to retail investors, so an AIFM marketing an AIF to professional investors would also need to ensure it is in compliance with the new rules.

Publication of national marketing requirements

What do the proposals say?

The NCA of each Member State would be required:

- to publish and maintain on its website a central database which contains “all applicable national laws, regulations and administrative provisions governing marketing rules for AIFs and UCITS, and the summaries thereof, at least in a language customary in the sphere of international finance”
- to notify these laws, regulations and provisions to ESMA (in a format and following procedures to be developed by ESMA), along with hyperlinks to the website where such information is published, and
- to notify ESMA without delay in the event of any change in the information provided.

ESMA would be required to maintain on its own website a central database which contains the laws, regulations and provisions notified to it.

Who do they apply to?

These proposals would apply in respect of (a) UCITS ManCos and (b) EU and non-EU AIFMs in relation to EU and non-EU AIFs.

What issues do the proposals raise?

These proposals seem both sensible and uncontroversial. They reflect the current requirements for UCITS under Article 91(3) of the UCITS Directive with the enhancement of the role for ESMA to oversee compliance under the new notification regime. Once again, however, the effect of the provisions is to ensure maximum harmonisation between Member States.

Verification of marketing communications

What do the proposals say?

Where a NCA requires a UCITS ManCo or an AIFM marketing an AIF to retail investors to notify it of any marketing communications which the manager intends to use in its dealings with investors, in order for the NCA to verify that such communications comply with relevant national marketing requirements, the NCA would have to:

- inform the manager of any request to amend its marketing communications within 10 working days of receiving its notification
- publish on its website the internal rules and procedures for such notification, and
- report annually to ESMA on decisions taken in the previous 12 months where it has either rejected or sought adaptation of any such marketing communication.

Who do they apply to?

These proposals would apply in respect of (a) UCITS ManCos and (b) EU and non-EU AIFMs in relation to EU and non-EU AIFs.

What issues do the proposals raise?

These proposals do not attempt to prevent Member States from requiring the verification of marketing communications. Instead, they try to harmonise the process, to introduce some transparency and to require accountability to ESMA. They also make it clear that Member States may not require prior verification of marketing materials as a pre-condition of marketing units in a UCITS or an AIF.

Fees and charges

What do the proposals say?

Fees and charges levied by a NCA would have to be proportionate to its expenditure in exercising its powers of authorisation, registration, supervision and investigation.

Each NCA would be required to notify ESMA of its levels of fees and charges and, where applicable, the methodology for calculating these. It would also be required to inform ESMA where any previously provided information had changed.

In turn, ESMA would publish on its website:

- an interactive database listing the fees, charges and calculation methodologies notified to it by the NCAs and, as part of this database, and
- an interactive tool for managers to make on-line calculations of the costs involved in a given Member State.

Who do they apply to?

These proposals would apply in respect of (a) UCITS ManCos and (b) EU and non-EU AIFMs in relation to EU and non-EU AIFs.

What issues do the proposals raise?

Again, these proposed changes appear to be uncontroversial and should provide managers with greater clarity.

Central database of all managers, AIFs and UCITS

What do the proposals say?

Within 30 months of the final Regulation entering into force, ESMA would be required to publish on its website, and maintain, a publicly accessible central database, which lists:

- all UCITS ManCos and AIFMs
- all AIFs and UCITS which those managers manage and market, and
- the Member States in which those funds are marketed.

Who do they apply to?

These proposals would apply in respect of (a) UCITS ManCos and (b) EU and non-EU AIFMs in relation to EU and non-EU AIFs.

What issues do the proposals raise?

On the wording of the Commission's proposals, ESMA would be required to include in its database details of all AIFMs - non-EU as well as EU and below threshold as well as above - and all AIFs. In practical terms, this would be an impossible provision for ESMA to comply with, as it would not, for example, receive notification in respect of a non-EU AIFM which did not manage or market an AIF in the EU. It is likely – and certainly to be hoped - that the final text which emerges as a result of the trilogue negotiations (see below) will limit the requirement (as we understand was the Commission's original intention) to EU AIFMs and EU AIFs or, at worst, to AIFs which are managed or marketed in the EU.

Some AIFMs - in particular, non-EU AIFMs - have expressed concern in the past at the idea of information regarding the AIFs which they market being publicly accessible. While it should be noted that, in the UK, the FCA already maintains a public, online database (the FCA Register) of all authorised AIFMs and UCITS ManCos, as well as all authorised and passported funds, the FCA Register does not include non-EU AIFs marketed in the UK under the NPPR (pursuant to either Article 36 or Article 42 of AIFMD).

What happens next?

The Commission has sent the proposed Directive and proposed Regulation to the Council of the EU (which comprises representatives of each of the 28 Member States' governments) and to the European Parliament.

These will, separately, consider what amendments they would wish to see made to the Commission's original proposals before they and the Commission meet together in trilogue meetings. In time, these negotiations will lead to an agreed final version of each text. The published Directive and Regulation could, therefore, differ greatly (or very little) from the original Commission proposals summarised above.

Once formally adopted and endorsed by the Parliament and Council, the texts will be published in the Official Journal. The Directive will "enter into force" the day following publication and the Regulation on the twentieth day following publication. Entry into force is a procedural step and does not mean that the legislation is yet in effect.

The Commission is, in this case, proposing a two year period following entry into force for Member States to transpose the Directive into national law. The Regulation, when implemented, would have direct effect in Member States without the need for transposition.

It seems inevitable that the final rules will not be applicable until after 29 March 2019, the date on which the notice of the UK's intention to leave the EU expires. It is possible even that the rules will not be in force even before any transitional period which might be agreed has ended. The specific impact that these rules, will have as far as UK AIFMs and UCITS ManCos are concerned will depend, to a large degree, on the final form of any agreement reached on Brexit. In any event, though, UK firms should take heed of the proposed changes as they may, in time, set a standard for third country managers seeking to market into the EU.

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