

So You Want to Market Funds in Europe? – Rules of the Road for Accessing Capital in Europe

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June 2017

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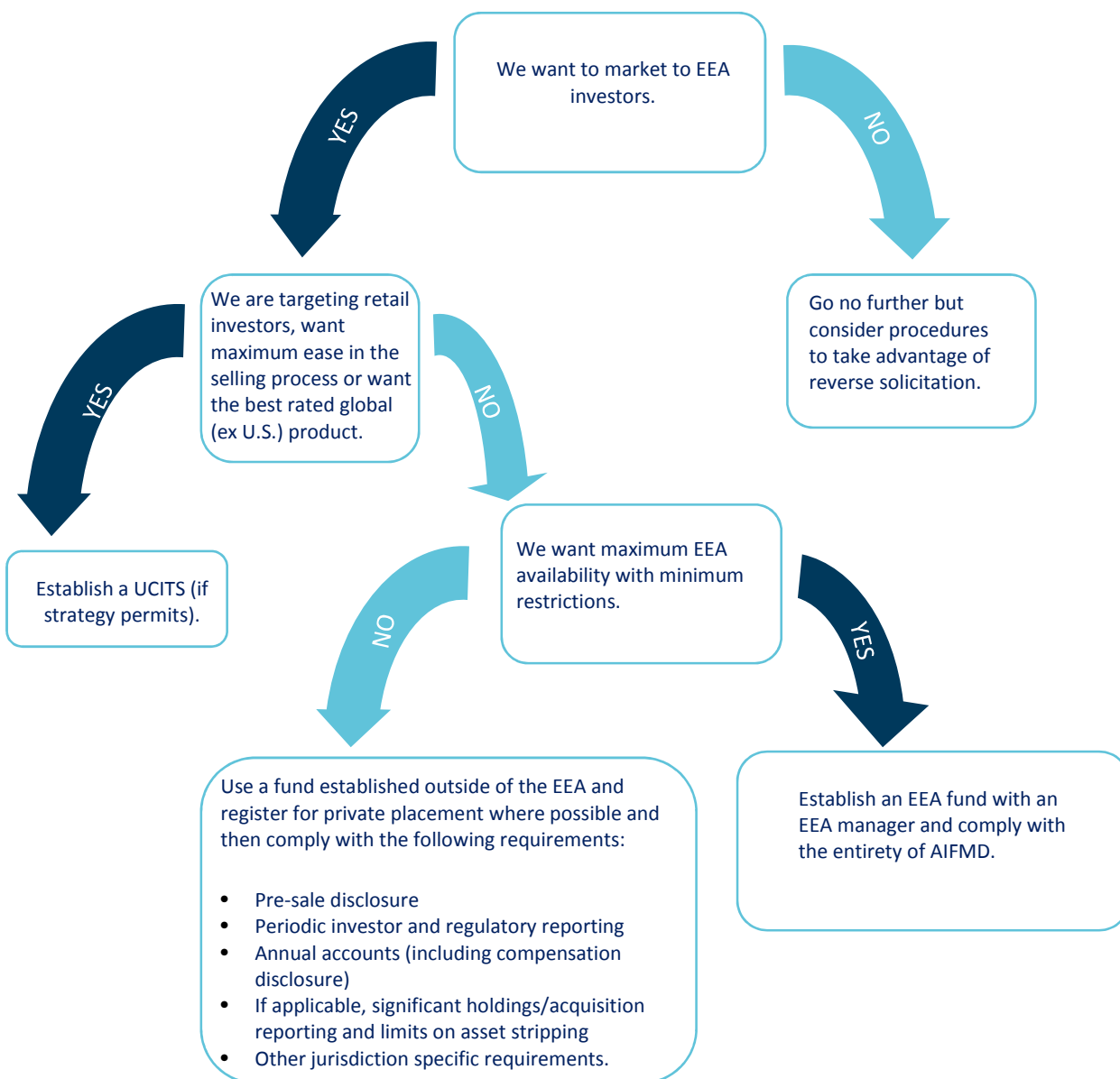
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The Question

Europe is the largest market for fund products after the United States. However, despite the advances of the European single market, there remains a confusing combination of pan-European and country specific rules governing the sale of these products in Europe.

The temptation for those new to capital raising in Europe may be to think ‘I’m not going to bother, this is going to take too much effort’ or even, ‘these rules don’t really apply to me.’ However, with forward planning and guidance, the European market remains open to the rest of the world.

The question then becomes, ‘given what I have to sell and who I want to sell it to, what is the best way for me to access those target investors?’ Set out below is a schematic to illustrate your main options.



A Technical Interlude

In order to discuss marketing into Europe there are a handful of technical concepts that it is helpful to understand:

What are we talking about when we say “Europe” in the context of fund marketing? Here it means the 28 members (including, for the time being, the United Kingdom) of the European Union (“EU”) together with the three additional countries (Iceland, Lichtenstein and Norway) which together with the EU comprise the European Economic Area (“EEA”). It does not include Switzerland which is outside of the EEA and has its own regime for fund marketing.

When we speak about a fund in this context, what do we mean? We are speaking about an alternative investment fund, or “AIF” which is in essence any open or closed ended investment fund that is not a UCITS (a European regulated fund product eligible for sale to retail investors), so it captures US mutual funds, private equity funds, hedge funds and other private funds.

Any discussion of marketing AIFs in Europe requires reference to “AIFMD”, so what is it? This is the EU alternative investment fund managers directive (2011/61/EU) which governs marketing and management of AIFs in the EEA.

So who is subject to AIFMD? AIFMD applies to the alternative investment fund manager, or “AIFM”, of an AIF, regardless of its jurisdiction of establishment, managing or marketing an AIF in the EEA. This means it would capture, for example, a US based manager marketing a Cayman Islands established fund into any EEA member state.

If we comply with AIFMD who can we market to? AIFMD covers marketing to “professional investors”. This includes financial institutions such as banks, large institutional investors, such as pension plans and insurance companies, and certain high net-worth companies, but generally not individuals and, at least from January 2018, local authorities. Some EEA member states permit marketing to a broader investor base (even retail) under their national laws.

So, do we need to worry about anything aside from AIFMD when marketing our fund to European investors? The answer here is yes. While AIFMD has provided a minimum set of requirements for marketing funds to professional investors, each EEA member state may, in accordance with its own national laws, set its own higher standards or more permissive regime in certain circumstances, including where a manager is seeking to market a non-EEA established AIF into that member state. National private placement regimes (“NPPRs”), therefore, vary on a state by state basis.

Identifying your Approach

The first question is whether you want to manage or market a fund in the EEA. If the answer to both is no then you can ignore the rest of this article; save for those who wish to avail themselves of so called “reverse solicitation”. In this case, see “Other Important Matters – What about reverse solicitation?” below.

If you want maximum ease in selling in the EEA, want to sell to retail and/or have a fund to sell globally which has a recognised stamp of quality then you should consider establishing a UCITS fund which will take you outside of AIFMD. You will then need to establish an EEA domiciled fund that meets, inter alia, a requirement to provide investors with liquidity not less than once every two weeks and meet strict diversification and asset eligibility criteria. This takes you to the gold standard of European funds. The rest of this article will focus on the ability to sell an AIF in the EEA.

So, for those who do not want to, or cannot, establish a UCITS fund but want to sell into the EEA, the question then becomes, where in Europe?

If your marketing plan is to target a few specific European jurisdictions and these jurisdictions have a user friendly NPPR (for example, the UK and the Netherlands), then private placement is probably the most efficient means for you to sell your fund into Europe. This, for example, is a good route for those promoters with, say, a Cayman master feeder designed for global marketing with limited sales into eligible EEA states plus, for example, Switzerland. This has been a favoured route in the past but, in the context of European marketing, is beginning to lose favour.

However, if your plan is to have the widest possible marketing effort or to target jurisdictions which have restrictive, no effective or no NPPRs (such as France, Italy and Spain) then your best option is to establish an EEA based fund with an EEA AIFM.

Decision – Private Placement

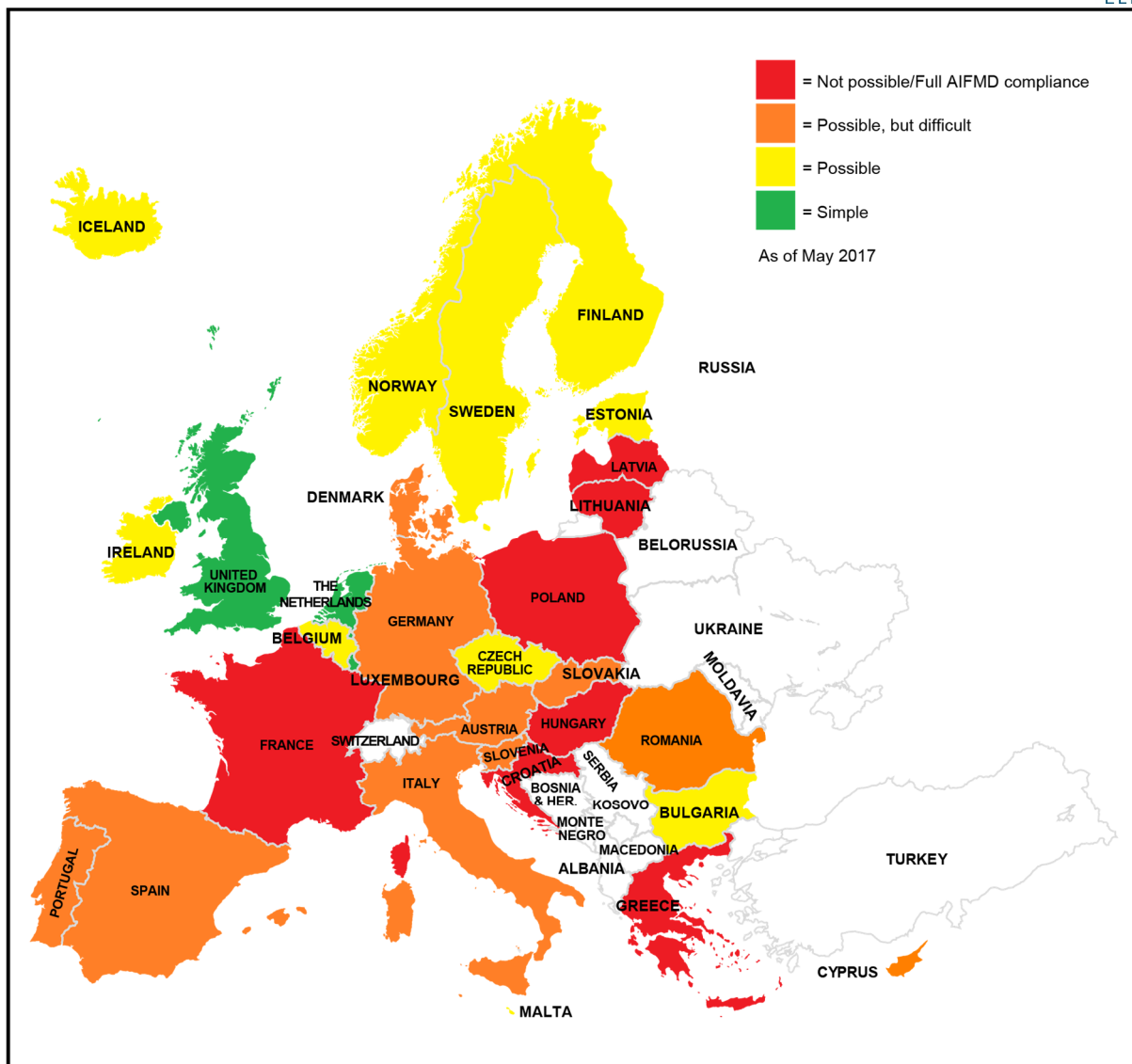
We would like to stick with our non-European fund, what are our obligations under the private placement route?

The requirements summarised below apply to non-EEA managers marketing non-EEA funds in the EEA. If you are an EEA based manager marketing a non-EEA fund you will also need to comply with all other aspects of AIFMD save for the requirement to have a single depositary, (but you will still need to appoint a “depositary lite” with responsibility for the custody of the fund’s assets, management of its cash and certain monitoring duties). See “What does it mean to be subject to the full scope of AIFMD?” below.

For countries with the simplest NPPRs, you will generally only need to comply with limited AIFMD requirements namely: (1) meet certain pre-requisites; (2) comply with pre-sale disclosure requirements; and (3) observe required continuing obligations.

Before commencing marketing, in each EEA member state in which you wish to market the fund, you will typically need, at a minimum, to: (a) make a filing with the local regulator; (b) pay the local fee (if any); and (c) if required by the local regulator, wait for confirmation that your filing has been accepted.

In some cases, a member state may have engaged in gold plating, requiring more than is mandated under AIFMD. This will increase your compliance obligations and may, in certain circumstances, make it so burdensome that private placement may not be a practical approach to capital raising in that jurisdiction. A classic example here would be Germany where, among other requirements, the fund must have a “depositary lite”. The map below provides a simple guide to the jurisdictions where private placement is easier and where it is more difficult or not possible.



Because NPPRs vary on a country by country basis, it is important to take advice prior to commencing private placement in order to determine whether there are any jurisdiction specific requirements in terms of, for example, disclosure, service providers, continuing obligations or filing requirements. Our internet based service, [World Compass](#), allows you to examine the obligations and opportunities with ease while our further internet based service, [World Passport](#), allows individual country registrations to be accomplished more simply. We consider below the core AIFMD requirements for private placement by a non-EEA manager of a non-EEA fund.

What are the prerequisites that we will need to meet before we make use of an NPPR under AIFMD?

These are that:

- (1) there is a cooperation arrangement for the purpose of information exchange (“**MOU**”) in place between each EEA member state in which you plan to market the fund and the jurisdiction(s) in which the fund and its manager are established. So, for example, if a US based manager were to market a Cayman Islands established fund into the UK and the Netherlands, it would need to ensure that there are MOUs in place between the Cayman Islands and each of the UK and the Netherlands and between the United States and each of the UK and the Netherlands (there are); and
- (2) the jurisdiction(s) in which the fund and the manager are established are not listed as Non-Cooperative Countries and Territories by the Financial Action Task Force (in the above case, they are not).

The vast majority of common fund jurisdictions have such MOUs in place, but you should confirm this before proceeding.

What are the pre-sale disclosure requirements?

AIFMD requires that specified information be made available to investors before they invest. Much of this information is of the kind that you would expect to find in an offering document that meets good market practice, e.g. a description of the investment objective and strategy and whether the fund will use leverage and the attendant risks.

Other required disclosures may need special attention. These include, for example, where an investor receives preferential treatment (such as under a side letter), a description of the nature of that treatment, who receives it and what their legal or economic links are with the fund or its manager.

The required disclosure can generally be included either in the main offering document for the fund or in a European marketing supplement to the offering document. Of course, there are always risks in providing some investors with more information than is offered to others.

What are our continuing obligations once we register our fund for private placement?

You will need to (a) continue to comply with the pre-sale requirements, (b) provide the annual accounts for the fund and periodic reporting to investors (c) provide the annual accounts and different periodic reporting to the regulator in each jurisdiction in which you have registered the fund for private placement, and (d) if the fund individually or jointly acquires control of (i) a non-listed company with a registered office in the EEA or (ii) a listed company with a registered office and admitted to trading on a regulated market in the EEA, comply with certain additional reporting obligations and requirements seeking to limit asset stripping. This is primarily designed to regulate the activities of private equity funds. In addition, material changes to the fund may require the submission of a material change form to the regulator in each jurisdiction.

What are our reporting obligations to investors?

You will need to provide periodic reporting to investors if there are changes to certain arrangements for the fund. For example, any change to the maximum level of leverage specified by the fund or the activation of any liquidity management tools (e.g. gates) must be notified to investors without undue delay.

Investors must be provided with an annual report for the fund no later than six months after the end of the fund's financial year. In addition to the normal content for such reports, you will need to include disclosure regarding any material changes to the pre-sale disclosure and information regarding the manager's remuneration requirements. This latter requirement includes the disclosure of (i) the total remuneration split into fixed and variable remuneration, paid by the manager to its staff for the financial year (including any carried interest) and the number of beneficiaries and (ii) the aggregate amount of remuneration broken down by senior management and staff whose actions have a material impact on the risk profile of the Fund. Some managers see this disclosure obligation as intrusive, but often an approach can be found with which the manager is comfortable.

What are our reporting obligations to the regulators?

You will need to provide the fund's annual report to the regulator in each jurisdiction in which you have registered for private placement.

In addition, you will need to provide a report to each regulator in each jurisdiction in which you are registered regarding the manager and the fund, commonly referred to as the Annex IV report. This report must be made on an annual, semi-annual or quarterly basis depending on the type of the fund and level of the manager's assets

under management for those funds it markets into the EEA. The form used to submit the Annex IV report differs from jurisdiction to jurisdiction and the information required is fairly extensive. It includes, for example, the principal markets, instruments and exposures of the fund, its investment strategy, borrowing and leverage arrangements and investor dealing history.

What additional obligations will we have if our fund acquires significant holdings in a non-listed EEA company or control over a non-listed or listed EEA company?

The obligations for funds with investments of this type include notification to the relevant regulator of acquisition of major holdings in non-listed EEA companies and notification of acquisition of control of non-listed or listed EEA companies to the relevant regulator, company and its shareholders. The manager must also provide information regarding the future of the acquired business and its potential impact on employment. Specific content requirements for the fund's annual accounts also apply.

In addition, a manager of a fund that acquires control of a listed or non-listed company must not facilitate or support and should use best efforts to prevent, any distribution, capital reduction, share redemption or acquisition of own shares by the acquired company for 24 months following acquisition.

How long do we need to comply with the continuing obligations?

This can vary on a country by country basis but, for example, in the UK you must comply with the continuing obligations from the time you register for private placement and, thereafter, for so long as you remain registered for private placement or have at least one EEA investor in the fund who invested on the basis of marketing under the NPPR.

Decision – Establishment of an EEA Based Fund

What are the advantages of establishing an EEA based fund?

EEA based funds with an EEA based AIFM can be marketed EEA-wide to professional investors under the AIFMD marketing passport. This requires a single filing for marketing purposes with the AIFM's home regulator and regulatory filings, such as the Annex IV report and annual accounts, need only be made to the AIFM's home regulator. Unlike the NPPRs, passport requirements may not be subject to gold plating. Accordingly, jurisdictions that may be difficult or impossible to access under the NPPRs, such as France, Spain and Italy, can be accessed as easily as any other EEA member state under the passport.

In addition continental investors often (rightly or wrongly) believe they can only invest in or make significant allocations to EEA funds. An EEA based fund, therefore, provides a manager with legal and practical access to a much larger investor base within Europe.

What are our obligations under AIFMD if we establish a European based fund?

If you establish a European based fund and utilise the marketing passport you will be subject to the entirety of AIFMD. This is because you will need to have a European based AIFM, which will be subject to the full requirements of AIFMD.

What does it mean to be subject to the full scope of AIFMD?

In addition to the disclosure and reporting requirements described above, the fund will need to have a single full depositary (a custodian with certain additional regulatory duties) in its jurisdiction of establishment. The AIFM will also need to comply with a broad set of requirements relating to, for example, conflicts of interest, risk

management, delegation, liquidity, leverage, valuation of the fund's assets, investment in securitized positions and more extensive remuneration obligations and restrictions.

What if we do not have or want to establish a management business in Europe?

Non-EEA managers may not be interested in incurring the cost and dealing with the operational requirements of setting up a management business in the EEA. A third party AIFM industry has sprung up in the last couple of years to address this issue. Based in the key EEA cross border fund jurisdictions of Ireland and Luxembourg (and elsewhere), these service providers will agree to act as a fund's AIFM for a fee. AIFMD prohibits an AIFM from delegating its functions to another person to the extent that the AIFM becomes a "letter box entity". To avoid this third party AIFMs will normally undertake risk management for Fund and delegate day to day portfolio management to the non-EEA manager, although for some funds such as PE and other strategies with limited investment activity, they may also act as the portfolio manager and look to the non-EEA manager for investment advice.

A key consideration in making use of such a third party AIFM is whether it has the necessary skill set and substance internally to oversee the risk management of the relevant fund strategy and effectively evidences such oversight. Without this, there is a risk that the AIFM will be deemed a "letter-box" entity by the relevant regulator and the non-EEA manager to which portfolio management or investment advice is delegated may be deemed to be the true AIFM (and therefore potentially losing the AIFMD marketing passport).

Other Important Matters

What about reverse solicitation?

Reverse solicitation is a sale of units in a fund that is made at the initiative of the investor (i.e. not at the initiative of the fund's manager) and does not therefore constitute marketing. Like private placement, what constitutes reverse solicitation is dependent on the law of the jurisdiction where the sale takes place or where the investor is resident or domiciled.

In isolated situations where the fund or manager has genuinely been approached by the investor who is accepted following a robust compliance process for which there is a clear paper trail, reverse solicitation may be relied on. However, it is not a marketing strategy!

If the relevant regulator determines that the sale constituted marketing and, accordingly, the manager violated the private placement rules, court action may well follow with civil and criminal sanctions. The relevant investor(s) may well have compensation or rescission rights (including the right to redeem from the fund at the value of its initial investment, not a happy scenario if the fund has failed to perform) and those involved in selling the fund may be subject to civil and/or criminal penalties (including imprisonment).

Doing it right is best from every perspective here!

What is the third country passport?

AIFMD provides for the possibility of a marketing passport for non-EEA managers and funds. If implemented, the private placement option might be eliminated. The European Commission, the EU body responsible for deciding whether the third country passport be implemented, has been dragging its feet and, given Brexit, is likely to continue with more deliberation than speed.

What about Brexit?

The United Kingdom gave notice on 29 March 2017 of its intention to withdraw from the EU, triggering a two year divorce process. While the end game cannot be determined with certainty, the worst case scenario is that following Brexit, any funds and managers established in the UK will be treated as non-EEA AIFs and non-EEA AIFMs.

In terms of the matters under discussion in this note, the only immediate implication is that an existing non-EEA manager who wishes to take advantage of the European-wide marketing passport may now wish to consider establishing their EEA fund in one of the EEA member states other than the United Kingdom.

In principle, upon Brexit the automatic right to rely on the marketing passport to sell into the UK will disappear. In practice, this is unlikely. The ability to access a wide variety of strategies and investment managers is a critical aspect in improving investment returns and, overall, reducing volatility. This is important to UK based investors whether they are pension funds, insurance companies, charities or individual investors. The UK government will likely put pragmatism and investor interest first and allow EU regulated funds to continue to be sold into the UK. Requiring specific new UK based funds to be formed in order to target UK based investors would lead to higher expenses and reduced choice for UK investors. See also our further briefing note on this subject "[UK Investment Managers: Any reason to be frightened by Brexit?](#)"

Note that none of the proposed Brexit changes will, as the law now stands, prevent a manager from managing money from London.

A version of this article was originally published in Law360.

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