NEW RULES ON CROSS-BORDER DISTRIBUTION OF INVESTMENT FUNDS IN THE EU

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UK & EU Investment Management Alert

By: Philip J. Morgan, Dr. Hilger von Livonius, Giovanni Meschia, Andrew J. Massey

The European Parliament and Council of the EU have adopted a package of measures intended to standardise and improve the cross-border distribution of investment funds in the European Union ("EU"). The principal features are:

▪ for alternative investment funds ("AIFs"), the introduction of a harmonised definition of "pre-marketing" and a notification requirement for AIF managers ("AIFMs") domiciled in the EU that wish to engage in pre-marketing to test the appetite of potential professional investors in new markets;

▪ for undertakings for collective investment in transferable securities ("UCITS"), removal of the onerous current requirement for certain investor facilities to be made available through a physical presence in the EU member state where the UCITS is marketed;

▪ for AIFs, the introduction of a new requirement for certain investor facilities to be made available in relevant EU markets where the AIF is to be marketed to retail investors;

▪ the introduction of procedures and conditions for UCITS, and EU AIFMs managing EU AIFs, where they decide to terminate the offering or placement of their funds in an EU member state;

▪ the introduction of new powers for regulators to require the pre-authorisation of marketing communications by UCITS managers or AIFMs which market AIFs to retail investors; and

▪ the introduction of a single online access point for information on national rules related to fund marketing requirements and applicable fees.

Firms that undertake marketing activities for UCITS or AIFs in the EU, or that engage distributors to market UCITS or AIFs in the EU, will need to consider the impact of the new requirements, most of which will take effect from 2 August 2021.

THE LEGISLATIVE PACKAGE, SCOPE AND TIMING

The changes form part of the European Commission's Capital Markets Union project and are an attempt to bring greater clarity and harmonisation to the cross-border marketing of EU-domiciled investment funds. Most of the new requirements apply directly only to EU-authorised managers of EU-domiciled funds.

The legislative package comprises a Directive (Directive (EU) 2019/1160) and Regulation (Regulation (EU) 2019/1156) on the cross-border distribution of funds (the "Directive" and the "Regulation", respectively), both of which entered into force on 1 August 2019. Most of the requirements are required to be applied from 2 August
2021, and EU member states will, by that date, be required to enact measures to implement the provisions of the Directive.

**PRE-MARKETING BY EU AIFMS MARKETING EU AIFS**

There will be new rules, effective 2 August 2021, which seek to harmonise the definition of "pre-marketing", i.e. marketing to professional investors [1] which may be undertaken before an application must be made for passporting/marketing rights under Articles 31 or 32 of the Alternative Investment Fund Managers Directive ("AIFMD"). The rules will also introduce new notification procedures for EU AIFMs undertaking pre-marketing. Currently, equivalent rules and regulator guidance, which may permit some pre-marketing in a similar way, differ across the EU. In some EU jurisdictions, including Italy, there is currently no useful regulator guidance as to what may amount to permissible pre-marketing before marketing rights are needed. In these places, the new harmonised definition may be of particular benefit to firms seeking regulatory certainty. For other jurisdictions, including Germany, which currently only have "light touch" regulation for pre-marketing activities, the new rules are likely to bring significant restrictions.

**Harmonised definition of "pre-marketing"**

"Pre-marketing" for the purpose of the new rule applying to EU AIFMs of EU AIFs will mean:

- 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 EU
- in order to test the investors' interest in an AIF or a compartment which is not yet established
- or in order to test their interest in an AIF or a compartment which is established, but not yet notified for marketing, in accordance with Article 31 or 32 of AIFMD, in that member state where the potential investors are domiciled or have their registered office
- and which does not amount to an offer or placement to the potential investor to invest in the units or shares of that AIF or compartment

New Article 30a of AIFMD will also clarify that certain activities are not pre-marketing – i.e. they are marketing and, as such, will be conditional on the obtaining of appropriate marketing rights under Article 31 or 32 of AIFMD. Such "full" marketing activities include the provision of subscription forms, even in draft, or of a final prospectus, even one relating to an AIF than has not yet been formed.

Draft prospectuses can be supplied as part of pre-marketing under the new rules but only with appropriate warnings and only as long as they do not "contain information sufficient to allow investors to take an investment decision". This latter requirement seems potentially problematic in relation to many draft prospectuses which may, in practice, need to be close to final in order to reach the point where they can, as a business matter, sensibly be circulated to potential investors. Thus, in practice, draft prospectuses may often not be able to fall into the pre-marketing rule. Some examples of communications that might qualify as pre-marketing are slide presentations, teaser documents and pre-prospectus marketing information covering relevant strategies or fund products.
Notification requirement for EU AIFMs undertaking pre-marketing

For EU AIFMs engaging in pre-marketing activities, within two weeks of the AIFM commencing pre-marketing as defined above (i.e. to professional investors to test their interest), the AIFM will need to notify its home member state regulator by "informal letter" or electronic means detailing when and where the pre-marketing is taking place, and in respect of which AIFs, stating their investment strategies.

Note that where the pre-marketing rule is used, it will still be necessary for the relevant AIFM to obtain passporting/marketing rights under Article 31 (for AIFM home state marketing) or Article 32 (for marketing in other EU member states) before units or shares in the relevant AIF may be acquired by investors.

Impact on reverse solicitation

A final point will reduce the circumstances in which an investment in an EU AIF may be characterised as a reverse solicitation. Under the terms of new Article 30a of AIFMD, commencement of pre-marketing of an AIF in any jurisdiction will automatically preclude any argument that a subscription by a professional investor to that AIF in the subsequent 18 months is the result of a reverse solicitation rather than marketing. This appears to apply even where the investor is in a different EU jurisdiction to the jurisdiction where the pre-marketing took place, and it will be interesting to see whether this point is clarified when member states implement the Directive. The rule also applies irrespective of any facts that might otherwise support a reverse solicitation argument. In Germany, there is existing regulator guidance that reverse solicitation may still be established where an investor was previously in receipt of pre-marketing materials if the investor subsequently makes an investment at their own initiative. This guidance conflicts with the new rule and will presumably need to be changed, thereby restricting the use of a reverse solicitation argument in Germany.

Possible application of pre-marketing rules to non-EU AIFMs and EU AIFMs marketing non-EU funds

It is notable that the new pre-marketing rules, on their terms, do not apply to any of the following situations:

EU AIFM marketing a non-EU AIF;
EU AIFM marketing an EU AIF to retail investors; and
Non-EU AIFM marketing any AIF into the EU.

Recital 12 of the Directive states that national laws regarding compliance with AIFMD and, in particular, the pre-marketing rules discussed above, "should not in any way disadvantage EU AIFMs vis-à-vis non-EU AIFMs". However, it remains to be seen how this will be interpreted in each EU member state, and it seems possible that it may lead to a new problem with inconsistent rules applying in different EU member states. One possibility is that, for complete consistency between EU and non-EU AIFMs, some, or even all, member states may choose to apply the new pre-marketing rules locally to all of the additional situations at i. to iii. in this paragraph. Certainly it is arguable, for example, that it would be disadvantageous for EU AIFMs versus non-EU AIFMs for the former to have to notify pre-marketing to regulators whilst the latter do not. By contrast, the question whether the
harmonised definition of pre-marketing could disadvantage EU AIFMs versus non-EU AIFMs would seem to depend on existing rules as to the scope of pre-marketing which, as noted above, are not consistent across EU member states. This is an issue that will need to be closely monitored as EU member states develop their own local laws to implement the new rules and any related rules addressing the additional situations at i. to iii. in this paragraph.

**CHANGES TO LOCAL FACILITIES REQUIREMENTS FOR UCITS, AND INTRODUCTION OF A MATCHING REQUIREMENT FOR AIFS SOLD TO RETAIL INVESTORS**

**UCITS facilities requirement changes**
The current UCITS Directive requires that local facilities are made available in EU member states in which a UCITS is marketed. Those facilities need to be able to make payments to unit-holders, repurchase or redeem units and make available the information that UCITS are required to provide to unitholders. Some EU member states require that this be a physical local facility and/or that there be a local service provider providing the relevant services. However, in practice, these local facilities are rarely used by investors and are costly.

In response to this problem, the new rules, which will be effective from 2 August 2021, whilst keeping the requirement for similar facilities, explicitly provide that there is no requirement that UCITS have a physical presence, or an appointed local service provider, in each EU member state in which a UCITS is marketed. This will allow fund managers to use electronic or other means of distance communication with investors to provide the relevant facilities, as is now possible given advancements in digital technologies.

**New AIF facilities requirement for marketing to retail investors**
At present, there are no analogous local facilities provisions in AIFMD, although the selling of AIFs to retail (i.e. non-professional) investors may be permitted at the discretion of individual EU member states under Article 43 AIFMD.

Under the new rules, AIFMD will be amended to introduce local facilities requirements that are very similar to those that will apply to UCITS after the new rules become effective. However AIFMs will only be subject to the new local facilities requirement in EU member states where the relevant AIF is marketed to retail investors.

**Additional considerations**
Under the new rules, both UCITS and AIFMs will need to provide the relevant facilities in each relevant EU member state in the official language of that country or in a language approved by the local regulator.

In addition, if a UCITS or AIFM uses a third party to provide any of the facilities, the third party must be subject to regulation and supervision in relation to the tasks to be performed.

**DISCONTINUATION OF MARKETING OF A UCITS OR AN EU AIF WHICH IS PASSPORTED FOR MARKETING IN AN EU MEMBER STATE OTHER THAN ITS**
HOME MEMBER STATE (IN THE CASE OF A UCITS) OR ITS AIFM'S HOME MEMBER STATE (IN THE CASE OF AN AIF)

Currently there are no clear and uniform conditions for the discontinuation of marketing of interests in UCITS, or EU AIFs which have EU AIFMs, in host member states. In relation to a UCITS, a host member state is for this purpose an EU member state other than the UCITS' home member state. In relation to an EU AIF with an EU AIFM, a host member state is an EU member state other than the home member state of the AIF's EU AIFM.

Under the new rules, effective 2 August 2021, the position will be standardised. Under the new procedure, a UCITS or EU AIFM will be required to submit a notification letter to its home member state regulator indicating that it has (a) (except in relation to closed-ended and European long-term investment funds) made a blanket offer, publicly available for at least 30 working days, to repurchase "free of any charges or deductions" all shares or units held by investors in the EU member state in which marketing is to be discontinued, and explaining the consequences of not accepting the offer; (b) made public in an appropriate way suitable for a typical UCITS or AIF investor its intention to terminate marketing and the consequences of that termination; and (c) varied or modified any contractual arrangements with intermediaries to prevent further offering of relevant interests.

The information referred to in (a) and (b) above is, in relation to UCITS, required to be in the official language of the relevant host country or in a language approved by the local regulator in the relevant host country.

The home member state regulator then has to establish whether the notification is complete and, when it is, the regulator has up to 15 working days to transmit the notification to regulators in relevant host member states and notify the UCITS or AIFM promptly that it has done this. At this point, the de-notification procedure is complete.

In the case of AIFs, no subsequent pre-marketing of the same interests (or of similar investment strategies or ideas) is permitted for 36 months from the date of de-notification in the relevant EU member state where marketing has previously been discontinued under the above procedure.

Possible wider application of discontinuation of marketing rules

It is notable that these new rules do not apply to discontinuance of marketing by:

A non-EU AIFM of an EU or non-EU AIF under national private placement regimes; or
An EU AIFM of a non-EU AIF under national private placement regimes; or
An EU AIFM of an EU AIF being marketed in the AIFM's home member state.

Recital 12 of the Directive, as mentioned above, could again be relevant, and could lead some EU member states to consider whether to extend similar concepts on discontinuation of marketing to the situations at i. to iii. in this paragraph. There will, however, be no necessity for any such extensions to be effected in a uniform manner.

UCITS REQUIREMENTS FOR MARKETING COMMUNICATIONS MADE MORE DETAILED AND EXTENDED TO EU AIFMS

In provisions becoming effective on 2 August 2021, the Regulation addresses the content of the marketing communications of EU-authorised AIFMs and UCITS management companies. It extends certain basic principles.
which are currently applicable to UCITS to EU-domiciled AIFMs. This includes the requirement that all marketing communications need to be clearly identifiable as such and that information in marketing communications must be clear, fair and not misleading. It also introduces a new requirement for both UCITS and EU-authorised AIFMs that the risks and rewards of purchasing shares of an AIF or interests in a UCITS be described in an equally prominent manner. Furthermore, the European Securities and Markets Authority (“ESMA”) is required to issue guidelines on the application of the new requirements for marketing communications by 2 August 2021.

**TRANSPARENCY OF MARKETING REQUIREMENTS AND REGULATORY FEES**

The Regulation also mandates better transparency of national AIF and UCITS marketing requirements and related regulatory fees. The provisions relating to marketing requirements come into force on 2 August 2021 whilst fee disclosures will need to be made by national regulators by 2 February 2020.

National regulators will be required to publish online, and notify to ESMA, all applicable laws, regulations and administrative provisions regarding marketing requirements for UCITS and AIFs, as well as summaries of them. They will also be required to publish online, and notify to ESMA, information on their fees relating to marketing requirements. These fees are required to be “consistent with the overall cost relating to the performance of the [relevant] functions of the [relevant regulator]”. Thus, there may be pressure on certain national regulators to reduce fees for certain services in connection with the implementation of fund marketing requirements.

ESMA will then, in turn, by 2 February 2022, be required to publish the information notified to it (and/or hyperlinks to that information) on its website. ESMA will also, from 2 February 2022, be required to publish on its website details of all AIFs and UCITS which are marketed in an EU member state other than the relevant home member state, including details of their AIFM or UCITS management company, and of the member states in which those funds will be marketed.

It is currently onerous, or in some cases expensive or even impossible, to find the information referred to in this section. Accordingly, the new transparency requirements may well significantly facilitate cross border marketing of investment funds across the EU, including by non-EU AIFMs, by providing access to this information.

**NEW POWER FOR REGULATORS TO REQUIRE THE PRE-AUTHORISATION OF MARKETING COMMUNICATIONS BY UCITS OR AIFMS WHICH MARKET AIFS TO RETAIL INVESTORS.**

National regulators have a new power under the Regulation, effective immediately from 1 August 2019, to require that UCITS management companies and AIFMs which market AIFs to retail investors provide prior notification to the regulator of marketing communications. The purpose of this would be to verify compliance with relevant provisions in the Regulation, when they become legally enforceable, and with any additional national marketing rules. Where national regulators do require notification of marketing requirements, they must make a decision within 10 working days whether to request any changes by the UCITS management company or AIFM. As of yet, there has been no indication as to whether the FCA is planning to use this power in the United Kingdom (“UK”).

**THE POSITION IN THE UK AFTER BREXIT**
As most of the rules described are not due to become effective for two years or more, it is not yet clear whether any of those rules will be applied in a post-Brexit UK. In any event, if passporting across the EU falls away for UK managers and funds, as seems likely, the rules described in this alert on local facilities and discontinuation of marketing in host member states would become redundant in relation to the UK. Other rules described in this alert may be onshored in the UK post-Brexit, to the extent relevant. For example, the UK could elect to apply the pre-marketing definition and notification to UK AIFMs marketing UK AIFs in the UK, or more broadly as it might choose. Likewise, the marketing communication requirements for AIFs, and the pre-marketing authorisation requirement, could be onshored by the UK.

NOTES

KEY CONTACTS

PHILIP J. MORGAN
PARTNER
LONDON
+44 (0)20.7360.8123
PHILIP.MORGAN@KLGATES.COM

HILGER V. LIVONIUS
PARTNER
MUNICH
+49 (0)89.321.215.330
HILGER.LIVONIUS@KLGATES.COM

HILGER V. LIVONIUS
PARTNER
MUNICH
+49 (0)89.321.215.330
HILGER.LIVONIUS@KLGATES.COM

GIOVANNI MESCHIA
PARTNER
MILAN
+39.02.3030.2959
GIOVANNI.MESCHIA@KLGATES.COM

ANDREW J. MASSEY
PARTNER
LONDON
+44 (0)20.7360.8233
ANDREW.MASSEY@KLGATES.COM

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